Supreme Court, U.S.
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In the

Supreme Court of the United States

DAVID W. OSTRANDER,
Trustee in Bankruptcy,

Petitioner,

v.

CITY OF SPRINGFIELD, MASSACHUSETTS,

Respondent.

Petition for a Writ of Certiorari to the
United States Court of Appeals for the First Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

1. Whether the constitutional principle of separation of powers is violated by a judicial determination that an interest of a bankrupt debtor is not property of the estate under 11 U.S.C. § 541 when the determination is based on a judicially created concept that is clearly at odds with the plain language and clear intention of the Bankruptcy Code.

2. Whether a court may, in the absence of a compelling federal interest, create a property interest for the benefit of a creditor of a bankrupt debtor that circumvents and contradicts state law definitions of property rights.

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OPINIONS BELOW

The August 16, 2002 opinion of the Bankruptcy Court (per Boroff, B.J.) is published at 281 B.R. 782 (Bankr. D. Mass. 2002). The September 26, 2002, order of the United States District Court for the District of Massachusetts affirming the opinion of the Bankruptcy Court is not reported. The May 19, 2003, panel decision of the United States Court of Appeals for the First Circuit (Lynch, S.L. joined by Boudin and Howard) affirming the holdings of the lower courts is published at 329 F.3d 204. The June 18, 2003 order of the Court of Appeals denying rehearing by the Panel and rehearing *en banc* is not otherwise reported.

JURISDICTION

The original opinion of the First Circuit was filed May 19, 2003. Petitioners' timely petition for rehearing *en banc* was denied on June 18, 2003. This petition for certiorari is timely in that Petitioner has filed it within 90 days of June 18, 2003. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS

1. 11 U.S.C. § 541

This Bankruptcy Code Section concerns and is entitled "Property of the Estate." It is reprinted in the Appendix at 60a.

2. 47 U.S.C. § 254

This statute created the federal "E-Rate " program and is commonly known as "The Telecommunications Act of 1996." It is reprinted in the

Appendix at 63a.

STATEMENT

I. Factual Background

The Telecommunications Act of 1996 (Telecom Act), 47 U.S.C. § 254, created what is known as the federal "E-Rate" program. The purpose of this program is to encourage public schools to connect to the internet. The E-Rate program subsidizes internet connections with funds extracted from the telecommunications industry, held in the Universal Service Fund's (USF) coffers and administered by a private corporation, the Universal Service Administrative Company (USAC).

USAC subsidizes contracts to provide telecommunications services to schools in two different ways. Normally, USAC pays its subsidies directly to the service provider; alternatively, a school may elect a payment method known as "Billed Entity Applicant Reimbursement" (BEAR). Under the alternative BEAR method, the school pays the service provider and later submits a form to USAC to direct payment to the provider. Schools choose the BEAR method in order to facilitate expedited completion of the project. In either case, USAC must pay only to the service provider because the Telecom Act specifically prohibits the USAC from paying the school directly. See *id.* at § 254 (e) (authorizing E-Rate payments only for "telecommunications carriers").

In 1999, LAN Tamers and Springfield entered into a $1,096,180.28 contract for the installation of a high-speed data network at Central High School and another in 2001 for network maintenance services at four

Springfield schools for $134,220. Both contracts have been completed in full, and the Springfield Schools are currently enjoying access to these high-speed data networks. Springfield paid the provider for both contracts as they were completed, thereby opting for the BEAR method of payment of its USAC subsidies. Petitioner contends that the choice of the BEAR method of payment, which is governed by a contractual relationship between Springfield and its service provider, created a creditor-debtor relationship between Springfield and service provider, LAN Tamers. In early 2002, after an appeal to the FCC, and after the installation had been completed by LAN Tamers, Springfield received funding commitment letters from the USAC stating that the USAC would issue BEAR payment totaling $1,070,056.74. Again, under the specific mandate of the Telecom Act, this payment may be made only to LAN Tamers. *Id.*

On May 20, 2002, LAN Tamers filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Because of the filing, USAC withheld the BEAR payments that were to be payable to the order of LAN Tamers by check under the Telecom Act and the regulations promulgated thereunder. The USAC is obligated to issue a $1,070,056.74 check payable to the provider but USAC has withheld payment and currently holds these funds.

II. Proceedings Below

After a proceeding instituted by a secured creditor of LAN Tamers asserting a valid, perfected, and enforceable secured interest in the USAC account receivable, and contested by Springfield, each claiming the proceeds, the Bankruptcy Court opined that the claims should be asserted in an adversary proceeding.

On June 4, 2002, Springfield filed an adversary proceeding claiming that the reimbursements were its property. The suit named LAN Tamers, its principal creditors and the USAC as defendants. One creditor, the Bank of Western Massachusetts, a secured creditor asserting a security interest in LAN Tamers' accounts receivable, counterclaimed. The official Unsecured Creditors' Committee was acknowledged as a party to the proceeding. The Bankruptcy Court took testimony on June 13, 2002, and heard post-trial oral argument on June 26. It issued an opinion on August 16, 2002. *City of Springfield v. LAN Tamers, Inc.* (*In re LAN Tamers, Inc.*), 281 B.R. 782 (Bankr. D. Mass. 2002). The Court attempted to create a federal common law constructive trust in order to support its holding that the reimbursements were not the property of LAN Tamers' estate. *Id.* at 792, 796-97. The concept of a "federal common law constructive trust" was neither raised, argued, or briefed before the Bankruptcy Court. The District Court affirmed this decision on September 26 in a one-page order.

In October, 2002, the Bankruptcy Court converted LAN Tamer's petition to Chapter 7 and appointed David W. Ostrander as trustee of the bankruptcy estate. The trustee was substituted for the Creditors' Committee in the appeal before the First Circuit Panel. The First Circuit Panel issued its decision on May 19, 2003. *City of Springfield v. Ostrander* (*In re LAN Tamers, Inc.*) 329 F.3d 204 (1st Cir. 2003). The Panel affirmed the District Court's decision, but not on a finding of a constructive or resulting trust under either federal or state common law. Instead the Court of Appeals determined that LAN Tamers never had equitable title to the USAC payment. Therefore, the Panel reasoned that the payment was never property of the estate under the Bankruptcy Code. In essence, the

First Circuit based its holding solely on its own characterization of the tripartite transaction as a "pass through," despite the fact that no state or federal law recognizes such a judicial determination as the source of a property interest in the course of a bankruptcy proceeding, and this Court's precedent forbids it.[1]

REASONS FOR GRANTING THE WRIT

I. Review is Warranted Because the Panel Decision of the First Circuit is in Direct Conflict with Several Relevant Decisions of This Court.

As the Panel's decision correctly notes, this Court has held that,

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979).

Butner established this Court's position on the origin of property rights within the context of a bankruptcy proceeding. As a default rule, property rights are creatures of state law. Alternatively, a compelling federal interest may forge a property interest where it is otherwise absent under state law. Thus, the law recognizes only three possibilities concerning

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[1]The purported doctrine had not been previously been raised, argued, or briefed by the parties nor was it addressed by the Bankruptcy Court nor the District Court whose findings have been based on different concepts.

Springfield's purported property interest in the subject USAC payment. Either Massachusetts state law gives Springfield a property interest in the payment; a compelling federal interest exists, sufficient to create a property interest in Springfield to the payment; or no such property interest exists. *Springfield has no property interest in the USAC payment.*

The Panel cites no Massachusetts statutory authority for the proposition that a transaction, judicially determined by the Court of Appeals as a "pass through," gives rise to an equitable property interest in the intended beneficiary. No such statute exists under Massachusetts state law, and no such doctrine exists under Massachusetts common law. In fact, the only possible source of Springfield's purported interest under Massachusetts law is a constructive trust, which is clearly inapplicable.

Massachusetts case law concerning constructive trusts is clear and unambiguous. Under Massachusetts law, "a court may apply a constructive trust approach only where the plaintiff has established that the property in dispute was acquired by fraud, mistake, breach of duty, or in other circumstances indicating the holder would be unjustly enriched." In re LAN Tamers, Inc., 281 B.R. 782, 793 (Bankr.D.Mass. 2002), citing *Fortin v. Roman Catholic Bishop*, 625 N.E. 2d 1352 (1994). In addition, a constructive trust is imposed only when there is a fiduciary duty between the debtor and the party seeking to establish the constructive trust. *Feinman v. Lombardo*, 214 B.R. 260 (D. Mass. 1997). For the above reasons, none of the lower courts found that Springfield holds an equitable interest in the USAC payment under Massachusetts state law.[2]

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[2]The Bankruptcy Court found that LAN Tamers holds the

Furthermore, the Court of Appeals did not even attempt to identify the compelling federal interest that is necessary for the creation of a property interest where no such interest exists under state law. See *Butner v. United States*, 440 U.S. 48, 55 (1979). In a footnote, the Panel states, "We need not decide precisely when state law would or would not apply. We simply conclude that this situation involves sufficiently significant federal interests." *In re LAN Tamers, Inc.*, 329 F.3d at 214 (1st Cir. 2003) at * 11 (FN6).[3] However, the opinion does not subsequently identify a federal interest adversely affected by the application of Massachusetts law sufficient to mandate the creation of an equitable interest in Springfield to the USAC payment. The only federal interest that the Panel cites is derived from the Telecom Act itself, and is in no way affected by the application of Massachusetts law. The Telecom Act

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USAC payment in a constructive trust under federal common law. But after both parties briefed the issue extensively, the First Circuit opinion affirmed the Bankruptcy Court's decision on entirely different grounds, without even discussing the obviously inapplicable concept of federal common law. "We think it better to avoid the language of trusts and rest our holding more simply on the fact that LAN Tamers, as a mere delivery vehicle, lacked an equitable interest in the reimbursement under the federal program." *In re LAN Tamers, Inc.*, 329 F.3d at 214.

[3]This admission demonstrates the Panel's own uneasiness with the basis for its holding. Because *Butner* is clear in its recognition of only two sources of a property interest, and the first (state law) does not apply, the Panel must deal with the concept of a controlling federal interest. The cursory treatment it gives to the "qualifying clauses" found in *Butner* and *Barnhill* neither address the issue of identifying a specific federal interest frustrated by the application of state law nor form the real basis for the Court's holding. The Panel is explicit in the fact that it bases its holding "*simply on the fact that LAN Tamers, as a mere delivery vehicle, lacked an equitable interest in the reimbursements under the federal program.*" (emphasis added) *Id.* Thus, the decision of the First Circuit Panel concedes the very analysis it misapplies.

provides, in pertinent part, that, "Elementary and secondary schools and classrooms... should have access to advanced telecommunications services." 47 U.S. § 254 (b) (6). In fact, this is the very language that the First Circuit Opinion quotes. *In re LAN Tamers, Inc.*, 329 F.3d at 214. But the application of Massachusetts state law concerning property rights is incapable of frustrating this interest *as the interest has already been fulfilled.* LAN Tamers has provided Springfield's "secondary schools and classrooms" with "access to advanced telecommunications services," which they currently enjoy. Because this federal interest has already been accomplished, the only interest that the federal government retains in this bankruptcy proceeding is in fulfilling the purpose of the Bankruptcy Code. "Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally." House Report No. 95-595, 95th Cong., 1st Sess. 340-2(1977); Senate Report No. 95-989, 95th Cong., 2d Sess. 49-51 (1978). By attempting to create a property interest in Springfield to the USAC payment, the Court of Appeals has given preference to a general, unsecured creditor in a bankruptcy proceeding, thereby frustrating an important, compelling, and codified federal interest. Thus, not only does the creation of a property right in Springfield to the USAC payment fail to advance a compelling federal interest, it frustrates an extremely important federal interest, the uniform and predictable application of the Bankruptcy Code.

In a 1992 decision, this Court noted that, "In the absence of any *controlling federal law*, 'property' and 'interests in property' are creatures of state law." (emphasis added) *Barnhill v. Johnson*, 503 U.S. 393, 398 (1992); citing *McKenzie v Irving Trust Co.*, 323 U.S. 365, 369-370 (1945). In 1994, this Court held that in the absence of a "clear and manifest" federal statutory

purpose, the Bankruptcy Code will be construed to adopt rather than displace state law. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544-545 (1994); *see also* English v. General Elec. Co., 496 U.S. 72, 79 (1990) (holding that congressional intent to supercede state laws must be clear and manifest).

The *Barnhill* and *BFP* reformulations of the *Butner* standard require that state law define property rights in the absence of *controlling federal law* articulating a *clear and manifest* federal purpose. No language in the Telecom Act controls property rights, and, as stated, the application of Massachusetts state law regarding property rights is not at odds with the purpose of the Telecom Act. Furthermore, the regulatory authority of USAC and the service provider's own manuals are incapable of being considered "controlling federal law" under the rule of law articulated in this Court's recent decision in *FCC v. Nextwave Pers. Communs., Inc.*, 123 S. Ct. 832 (2003). *Nextwave* held that dischargeability can not be tied to the existence of regulatory authority under the Bankruptcy Code. In other words, regulatory authority is incapable of altering property rights over which a bankruptcy court has jurisdiction in a bankruptcy proceeding. Therefore, the Bankruptcy Code, itself, is the only possible candidate for such "controlling federal law."

Although the Bankruptcy Code does not "invariably incorporate state law," it is presumed to do so in the absence of a "clear and manifest" federal statutory purpose. See *BFP*, 511 U.S. at 544-545. Neither the text of § 541 (d) nor its legislative history contain a "clear and manifest" purpose to supersede state property law on a "pass through" theory. The now famous insurance example found in the legislative

history of the Telecom Act illustrates *only* the fact that the corpus of an actual *constructive trust* is not property of the estate. S. Rep. No. 95-989 (1978), at 82, reprinted in 1978 U.S.C.C.A.N. 5783, 5868; H.R. Rep. No. 95-595 (1978), at 368, reprinted in 1978 U.S.C.C.A.N. 5963, 6324. This example is inapplicable to *LAN Tamers* because the Panel did not find a constructive trust, nor could it have done so under Massachusetts law.

Understanding this, the First Circuit Panel attempts to sidestep the operation of law by stating:

> "We think it better to avoid the language of trusts and *rest our holding more simply on the fact that LAN Tamers, as a mere delivery vehicle, lacked an equitable interest in the reimbursements under the federal program.*" (emphasis added) *In re LAN Tamers, Inc.*, 329 F.3d at 214.

But property is possessed of both legal and equitable title. Therefore, it is not enough for the Court of Appeals to say only that LAN Tamers lacked equitable title to the USAC payment without further identifying the holder of equitable title to the subject payment. In other words, if LAN Tamers does not hold the equitable title to the USAC funds, someone must. Conceptually, Springfield is the only possible holder of such title, but as discussed, is not. This Court recognizes only two sources of a property interest in the context of a bankruptcy proceeding– state law or a compelling federal interest, neither of which apply. See *Butner v. United States*, 440 U.S. 48, 55 (1979); *Barnhill v. Johnson*, 503 U.S. 393, 398 (1992). Indeed, the Telecom Act specifically payment to anyone other than the provider, LAN Tamers. See 47 U.S.C. § 254.

Separation of legal and equitable title does not happen magically, abra cadabra, by the mere recitation and reiteration of the phrase "pass through." The First Circuit Panel neither finds the creation of a trust nor offers any other state law source of Springfield's mysterious equitable title. The Panel merely labels the transaction a "pass through" without reference to any law stating that a "pass through" transaction gives birth to a spontaneous equitable title. *In fact, there is no state or federal law that creates an equitable interest in the intended beneficiary of a "pass through" transaction.* The First Circuit Panel has, therefore, attempted to give Springfield an equitable interest that it does not have by passing over the identification of the property right's source mandated by logic and, more significantly, this Court's unambiguous precedent.

I. Review is Warranted Because the First Circuit Panel has Decided an Important Question of Federal Law that Has Not Been, But Should Be, Settled By This Court

The Decision of the First Circuit Panel sets a national standard for the creation of judge-made law that is clearly at odds with a controlling federal statute. As such standard is inconsistent with the bedrock constitutional principle of the separation of powers, it merits the immediate attention of this Court.

A. Springfield is a General Unsecured Creditor of LAN Tamers

The purpose of the Bankruptcy Code is clear: "[bankruptcy] is designed to provide an orderly liquidation procedure under which all creditors are treated equally." House Report No. 95-595, 95th Cong., 1st Sess. 340-2 (1977); Senate Report No. 95-989, 95th

Cong., 2d Sess. 49-51 (1978). Under the Bankruptcy Code, a "creditor" means an entity that has a claim against the debtor originating at or before the order for relief. See 11 U.S.C.§ 101 (10)(A). Springfield is unarguably a creditor of the debtor, LAN Tamers. Springfield's claim to the USAC payment that is due to LAN Tamers, arose only as a result of Springfield's voluntary pre-payment to LAN Tamers, the service provider. The pre-payment predates LAN Tamers' Chapter 11 filing. Springfield's alleged entitlement to said funds is clearly a "claim" under the Bankruptcy Code, as a "claim" in bankruptcy includes *any right to payment.* 11 U.S.C. § 101(5)(A) (emphasis added). Further, this Court has recently affirmed that "(w)e have said '(c)laim' has 'the broadest available definition,' *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991), and have held that the plain meaning of a 'right to payment' is nothing more nor less than an enforceable obligation, regardless of the objectives the state seeks to serve in imposing the obligation," *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 559 (1990). *See also Ohio v. Kovacs*, 469 U.S. 274 (1985).[4]

B. The USAC Payment is Property of the LAN Tamers Estate

Section 541 (a) (1) defines property of the estate as all legal or equitable interests of the debtor. This section has traditionally been interpreted broadly, as its legislative history mandates.

> "The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of

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[4] In short, "a debt is a debt, even when the obligation to pay it is also a regulatory condition." *Nextwave*, slip, op. at 9.

> action (see Bankruptcy Act §§ 70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act." H.R.Rep. No. 95-595, p. 367 (1977); S.Rep. No. 95-989, p. 82 (1978), U.S.Code Cong. & Admin.News 1978, pp. 5868, 6323.

LAN Tamers property interest in the USAC payment falls well within this broad definition of property of the estate under Section 541 (a) (1) of the Bankruptcy Code. In fact, Springfield has never contested this issue. Alternatively, Springfield has argued, and the First Circuit Panel has agreed, that Petitioner's § 541 (a) (1) property interest in the USAC funds is limited by § 541 (d), which states:

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such a mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold. 11 U.S.C. § 541 (d).

The argument that LAN Tamers property interest in the USAC payment is limited by this section of the Bankruptcy Code is erroneous. Because the Bankruptcy Code must defer to state law for its definitions of property rights absent a compelling federal interest,

Butner v. United States, 440 U.S. at 55, the qualification of property of the estate inherent in Section 541 (d) operates within the parameters of Massachusetts state law defining property rights. As stated, under Massachusetts law, both legal and equitable title remain in the hands of Petitioner. See *supra* discussion of Massachusetts law of constructive trust pp. 8-9. Section 541 (d) is therefore inapplicable.

C. The First Circuit Panel has Created a Judicial Doctrine Directly at Odds with the Language and Purposes of the Bankruptcy Code.

The Bankruptcy Code's overarching policy is ratable distribution among creditors. The Code's broad definition of property of the estate is an explicit congressional expression that general unsecured creditors, such as Springfield, are to be treated alike in the course of a bankruptcy proceeding, and receive distribution *pro rata* Such a result is consistent with congressional intent and is in keeping with the policy choices that the very allowance of bankruptcy represents.

The decision of the First Circuit Panel commits an effrontery to this plain statutory language and clear legislative intent by relying on a judge-made doctrine to achieve a desired result. The doctrine of "pass through," as used by the First Circuit Panel, is clearly at odds with the statutory language and purpose of the Bankruptcy Code.

The First Circuit Panel infers a severance of legal and equitable title to the USAC funds by means of a judicial doctrine it labels a "pass through." No such doctrine exists under Massachusetts common law. As

Massachusetts law controls property rights in the case at hand, there is no legal basis for the finding that legal and equitable title to the USAC payment was split by the operation of a judicial construction external to Massachusetts law.

Moreover, there exists no legal authority stating that the judicial determination of a "pass through" creates some sort of *sui generis* property right in the intended beneficiary– bar none. In fact, the Panel cites only one case that actually employs "pass through" language, *Yonkers Bd. of Education v. Richmond Children's Ctr.*, 58 B.R. 980 (S.D.N.Y. 1986). But the *Yonkers* Court only uses the "pass through" description for the purpose of deciding whether to apply the New York state constructive trust law.

> [A] constructive trust, determined in accordance with state law, is not a part of the Debtor's estate...[T]his court must apply the New York law affecting constructive trusts in this context. *Id.* at 982.

In other words, the *Yonkers* Court employed the concept of "pass through" in a very limited capacity. The description served only as an analytic tool to help the court determine whether a specific New York state law giving birth to a property right should apply. It did not, as the First Circuit Panel would like to believe, use the "pass through" doctrine as an alternative and independent source of that property right.

Similarly, the Panel's reliance on *In re Joliet-Will County Community Action Agency* is misplaced. 847 F.2d 430 (7th Cir. 1988). The *Joliet* case held that the

proper inquiry into whether federal grant monies are property of a bankrupt estate is: who owns the money? *Id.* at 433. The Seventh Circuit concluded that,

> "The answer depends on the terms under which the grants were made. Did they constitute [the debtor] a trustee, custodian, or other intermediary, who lacks beneficial title and is merely an agent for the disbursal of funds belonging to another?" *Id.* at 432.

The *Joliet* Court then went on to evaluate a number of factors bearing on this issue.

The First Circuit Panel misconstrues this language in assuming that the Seventh Circuit recognizes the right of a court to create a property interest in the intended beneficiary of what it has deemed a "pass through" transaction. Such is not the case. The funds in question in *Joliet* had been dispersed by a federal agency. The Seventh Circuit, simply, assumed that the federal government *already* has a property interest in grant monies held by the grantee and not expended according to the terms of the grant. The language of the opinion reveals this assumption. "We can find no evidence that the authors of the Bankruptcy Code intended to deprive the federal government of property rights it would enjoy against an unsecured creditor..." *In re Joliet-Will*, 847 F.2d at 433. In fact, this Court has specifically held that federal funds in the possession of a grantee remain the property of the federal government unless and until expended in accordance with the terms of the grant. *Buchanan v. Alexander*, 45 U.S. 20 (1845) (Mem), 4 How. 20, 11 L.Ed. 857; *see also Palmiter v. Action, Inc.*, 733 F.2d 1244 (7th Cir. 1984) (following this precedent). Thus, unlike the

First Circuit Panel, the decision and order of the *Joliet* Court created no new property interest, because the federal government's property interest in the funds at stake preexisted its order.

Conversely, the First Circuit Panel has conjured Springfield's property interest out of thin air. As the Panel Opinion correctly notes, "[t]he USF monies are not appropriated federal funds." *In re LAN Tamers, Inc.*, 329 F.3d at 206. USAC is a private corporation, not a federal agency. Therefore, the *Joliet* assumption is inapplicable. Springfield had no property interest in the USAC funds prior to the First Circuit Panel's decision. The question that this Court must decide is *whether a court may by judicial decree create a property interest at odds with a federal statute.*

Petitioner has found no authority supporting the right of a court to do so. Such judicial fiat disrupts the delicate balance of federalism by creating a property right where the state legislature and judiciary have deliberately failed to do so. If allowed to stand, the Opinion of the First Circuit Panel would "constructively" overturn Massachusetts law concerning constructive trusts as well as frustrate the purposes of the Bankruptcy Code– an integrated and comprehensive statutory framework of federal law. Such a result offends principles of federalism and violates the separation of powers. This Court must not allow a federal court the power to change a result that Congress has clearly intended and specifically addressed.

I. Review is Warranted To Resolve Confusion Among the Lower Courts and Alleviate an Inconsistent Area of Important Federal Law.

Several Circuit Courts of Appeals have

considered the issue of when a constructive trust is created or when it may be imposed so as to exempt its corpus from property of the estate under 11 U.S.C. § 541(d). Their divergent approaches, based on vastly different interpretations of *Butner* and its progeny, have led to disparate and uncertain outcomes. A bright-line test to determine when a constructive trust properly exempts property from a bankrupt estate is needed in order to promote uniformity in this important area of federal law. Such a test would also promote judicial economy by quelling ceaseless litigation in this uncertain area.

The approaches taken by the circuit courts are best characterized as falling along a continuum. The Sixth Circuit decision of *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.)*, 16 F.3d 1443 (6th Cir. 1994), is at one end. In *In re Omegas Group, Inc.*, the Sixth Circuit observed that "[n]owhere in the Bankruptcy Code does it say, 'property held by the debtor subject to a constructive trust is excluded from the debtor's estate.'" *Id.* at 1448. In other words, because a constructive trust, unlike an express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision finding her entitled to a judgement "impressing" defendant's property within a constructive trust. *Id.* at 1451. Therefore, a creditor's claim of entitlement to a constructive trust is not a *prepetition* "equitable interest" in the debtor's estate. *Id.* This approach places great emphasis on the clear language of Section 541 (d), which excludes only "[p]roperty in which the debtor holds, *as of the commencement of the case*, only legal title and not an equitable interest..." 11 U.S.C. § 541 (d) (emphasis added). Subsequent Sixth Circuit cases to consider the rationale of the *Omegas* holding have concluded that it is based solely on bankruptcy policy. See, *e.g. In re Dow Corning Corp.*,

192 B.R. 428, 441 (Bankr. E.D. Mich. 1996) (finding that the rationale for the *Omegas* holding was based on the identification of the Bankruptcy Code's policy of ratable distribution as a compelling "federal interest" under *Butner*).

The Ninth Circuit approach acknowledges that state law determines whether a constructive trust is established, but like the recent *Dow Corning* decision from the Ninth Circuit, sees the Bankruptcy Code policy of ratable distribution as a check on the imposition of such constructive trusts under state law. In effect, the Ninth Circuit approach may be summarized as follows: (1) the claimant must first establish her entitlement to a constructive trust under state law; (2) if the claimant meets this burden, the court will still refuse to impose the constructive trust if the debtor or trustee proves that to do so would be contrary to the policy of ratable distribution, a burden of proof met if the debtor stood in a "debtor-creditor" relationship; and (3) unless the constructive trust was choate prepetition, the constructive trust remains vulnerable to avoidance under § 544 even if it runs the policy gauntlet. Robert J. Keach, Article: *The Continued Unsettled State of Constructive Trusts in Bankruptcy: Of Butner, Federal Interests and the Need For Unoformity*, 103 Com. L.J. 411 at 427 (Winter 1998). Thus, like the Sixth Circuit, the Ninth Circuit approach acknowledges that a constructive trust is a remedy-type of property right. *Airwork Corp. v. Markair Express* (*In re Markair, Inc.*), 172 B.R. 638 (B.A.P. 9th Cir.Alaska 1994). Unlike the Sixth Circuit, however, the Ninth does not view bankruptcy policy as a blanket bar to property rights created under state laws imposing constructive trusts. Rather, the Ninth Circuit approach respects a property right arising under state constructive trust law, unless such a recognition frustrates the equities contemplated

by bankruptcy policy. *Elliott v. Bumb*, 356 F.2d 749 (9th Cir.Cal. 1966), cert denied, 385 U.S. 829 (1966) (holding that although state law determines whether a constructive trust is established and a res identified, a federal question still exists regarding what is the distribution contemplated by bankruptcy in the situation at bar); *Torres v. Eastlick* (*In re North American Coin & Currency, Ltd.*), 767 F.2d 1573, 1575 (9th Cir. 1985), *cert denied*, 475 U.S. 1083 (1986) ("we cannot accept the proposition that the bankruptcy estate is automatically deprived of any funds that state law might find subject to a constructive trust"); *In re Lewis W. Shurtleff. Inc.*, 778 F.2d 1416, 1419 (9th Cir. 1985) (finding that when the balance of equities between a claimant and the debtor's other creditors is uncertain, there exists a strong policy in favor of ratable distribution among creditors which weighs heavily against imposition); *Mitsui Manufacturers Bank v. Unicom Computer Corp. (In re Unicom Computer Corp.)*, 13 F.3d 321, 325 n.6 (9th Cir. 1994) (stating that while state law must be the starting point in determining whether a constructive trust may arise in a federal bankruptcy case, the law must be applied in a manner not inconsistent with federal bankruptcy law).

The traditional approach, taken by the majority of courts, allows a bankruptcy court to impose a constructive trust and exclude its corpus from property of the estate under Section 541 (d) if two conditions are met. First, the existence and legal source of the constructive trust relationship must be established. Keach, *The Continued Unsettled State of Constructive Trusts In Bankruptcy* at 420. With a nod to *Butner*, this showing is seen exclusively as a function of state law. *Id.* Second, the res must be traced or identified, which is a question of federal law. *Id.* at 420-421.

Courts following this traditional approach are quite conscious of the tension that exists between imposing a constructive trust and respecting the Bankruptcy Code's strong policy of ratable distribution. As such, they are admittedly cautious about imposing constructive trusts in a bankruptcy situation. *Id.* at 422. Unlike the result-minded Sixth and Ninth Circuits which focus on the actual frustration of bankruptcy policy in barring or limiting the imposition of constructive trusts under state law, the traditional approach protects the policy of ratable distribution by requiring that state law be strictly applied in determining whether a constructive trust will be imposed on the facts before the court.[5] Similarly, some courts will require establishment of the state law predicate for imposition of a constructive trust (i.e., fraud, fiduciary relationship, etc.) by clear, convincing and unambiguous evidence. *Id.*[6]

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[5] *Id.*; *e.g.*, *Haber Oil, Inc v. Swinehart* (*In re Haber Oil, Inc.*), 12 F.3d 426, 434-37 (5th Cir. 1994) (state law strictly applied); *Dorfman v. Moorhous* (*In re Moorhous*), 180 B.R. 138 (Bankr. E.D. Va. 1995) (constructive trusts should not be "cavalierly imposed"); *Skilled Nursing Proessional. Servs. v. Sacred Heart Hosp.* (*In re Sacred Heart Hosp.*), 175 B.R. 543, 557-59 (Bankr. E.D. Pa. 1994) (same); *Rotman Eletrical. Co. v. Cullen*, 145 B.R. 719, 727-28 (Bankr. D. Mass. 1992) (same); *In re Leedy Mortg. Co.*, 111 B.R. 488, 494 (Bankr. E.D. Pa. 1990) (bankruptcy courts "wary" of imposing constructive trusts).

[6] See, *e.g.*, *In re Sacred Heart Hosp.*, 175 B.R. at 554-55 (plaintiff bears burden of establishing a constructive trust by evidence which is "clear, precise and unambiguous"). *See also*, *Wachovia Bank, N.A. v. Vacuum Corp.* (*In re Vacuum Corp.*), 215 B.R. 277, 281-82 (Bankr. N.D. Ga. 1997) ("Since,... the generation of constructive trust substantially offends the Bankruptcy Code's general goal of equal distribution, courts generally will require that nonbankruptcy grounds for imposing a constructive trust 'be so clear, convincing, strong and uniquivocal as to lead to but one conclusion'.") (footnote and citations omitted).

The three approaches discussed above operate to narrow the circumstances under which a bankruptcy court will impose an otherwise supportable constructive trust: the Sixth Circuit by barring imposition altogether on bankruptcy policy grounds, the Ninth Circuit by suggesting that bankruptcy law and policy may intervene so as to narrow allowable impositions, and the traditional approach by making it more difficult to satisfy the preconditions of a constructive trust under state law. The Third Circuit's opinion in *Official Comm. of Unsecured Creditors of Columbia Gas Transmission Corp. v. Columbia Gas Syst.* (*In re Columbia Gas Syst.*), 997 F.2d 1039 (3rd Cir.Del. 1993), does just the opposite. In *Columbia Gas*, the Third Circuit implied that federal bankruptcy law and policy may support the imposition of a constructive trust where applicable state law would not support imposition.

Facially, this position is not inconsistent with *Butner*'s "federal interest" exception. Closer examination, however, reveals the absence of a rationale capable of supporting the Court's holding. The *Columbia* Court created an equitable interest in the intended beneficiary of a constructive trust that it imposed under "federal common law". *Id.* at 1054. In other words, the Third Circuit attempted to create federal common law imposing a constructive trust in a situation in which the debtor acted as a mere conduit. The *Columbia* Court cited the slim legislative history of Section 541 (d) as the basis for its decision. See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 368 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5963, 6324.

> Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the

> debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in constructive trust for the person to whom the bill was owed. *Id.*

The Third Circuit, effectively, interpreted this piece of legislative history as a loophole to *Butner*, allowing it to create a federal common law of constructive trust in a conduit situation. This approach, once again, offends federalism. Federal common law may be used only to fill "gaps" left in a comprehensive federal statutory scheme, but no such "gaps" exist in Section 541 of the Bankruptcy Code. The intended recipient of funds, held by a bankrupt debtor, who owns no equitable interest under applicable state law nor has acquired an equitable interest pursuant to a compelling federal interest, holds no equitable interest "as of the commencement of the case." The language of § 541 (d) is clear and unambiguous. The insurance example acts as a mere illustration of the clear language. It does not anticipate "gaps" in the very statutory section it attempts to clarify.

These four different approaches to the imposition of constructive trusts, exclusion of funds from property of the estate, and interpretations of this Court's precedent lead to extremely divergent results, thereby creating an unpredictable climate for commercial transactions. Because the notion of a "compelling federal interest" can be construed in so many different ways, there is little hope that this important federal issue will resolve itself.

Petitioner respectfully suggests that this Court endorse an interpretation of Section 541 (d) that gives sufficient weight to the Bankruptcy Code's central policy of ratable distribution. Further, this Court should welcome the opportunity to clear up the confusion among the Circuit Courts and set precedent which respects the allocation of risk intended in commercial transactions. It is clearly inequitable to allow a claimant who has chosen to enter into an ordinary creditor-debtor relationship primacy over other creditors similarly situated. The *LAN Tamers* opinion attempts to set a national rule that would do just that.

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be granted.

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(Any footnotes trail the end of each document.)

No. 02-2309

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

IN RE LAN TAMERS, INC.,
Debtor.

CITY OF SPRINGFIELD, MASSACHUSETTS,
Plaintiff, Appellee,

v.

DAVID W. OSTRANDER, Trustee in Bankruptcy,
Defendant, Appellant,

LAN TAMERS, INC.; BANK OF WESTERN MASSACHUSETTS; EDUCATIONAL TECHNOLOGY, INC.; UNIVERSAL SERVICE ADMINISTRATIVE COMPANY; OFFICIAL UNSECURED CREDITORS' COMMITTEE OF LAN TAMERS, INC.,
Defendants.

May 19, 2003, Decided

COUNSEL: Eugene B. Berman, Kerry David Strayer, and Kamberg, Berman, P.C. on brief for defendant-appellant.

Joseph B. Collins, George I. Roumeliotis, Hendel & Collins, Harry P. Carroll, Deputy City Solicitor, Melissa M. Shea, Associate City Solicitor, and Springfield Law Department on brief for plaintiff-appellee.

Joseph H. Baldiga and Mirick, O'Connell, DeMallie &

Lougee, LLP on brief for Universal Service Administrative Company, amicus curiae.

JUDGES: Before Boudin, Chief Judge, Lynch and Howard, Circuit Judges.

OPINIONBY: LYNCH

OPINION: LYNCH, Circuit Judge. This case involves competing claims of the Springfield, Massachusetts public schools and the creditors of LAN Tamers, Inc., a bankrupt company, to a million-plus dollars. The case arises from the intersection of the federal Bankruptcy Code and the federal "E-Rate" program, created by the Telecommunications Act of 1996 to encourage public schools to connect to the internet. The E-Rate program subsidizes these internet connections with funds extracted from the telecommunications industry and administered by a private not-for-profit corporation, the Universal Service Administrative Company (USAC). The schools contract with service providers to do the connection work. USAC, through the Universal Service Fund (USF), either pays the subsidy to the service provider directly (if the approved schools have not already paid in full) or reimburses the schools for part of the cost (if the projects have been approved and the schools have paid the service provider for the work). In the latter case, USAC actually makes its payment to the service provider, who in turn must pass the funds through to the school.

The issue here is whether reimbursement monies, presently held by USAC, are part of the estate of LAN Tamers, the bankrupt service provider. When LAN Tamers filed for bankruptcy, Springfield had already paid it in full for installation and maintenance of internet networks at various schools. USAC had already

approved E-Rate funding for the projects. The bankruptcy court and district court both held that these funds belong to Springfield and are not the property of the estate. We affirm.

I.

The facts about the structure of the E-Rate program and the events are undisputed.

One of the goals of the 1996 Telecommunications Act was to encourage universal telecommunications service. Universal service includes "advanced telecommunications and information services," particularly high-speed internet access, for schools (as well as for libraries and rural health care providers). See 47 U.S.C. § 254(b)(6), (h)(1) (2000). The internet highway for these schools is paved with mandated contributions from the telecommunications industries; the USF's coffers are filled by interstate telecommunications providers who pay mandatory charges, which they typically pass on to consumers in their bills. See id. § 254(d); 47 C.F.R. § 54.706 (2002). Federal regulations give USAC the responsibility to administer the USF, collect the charges, and disburse its funds, all under the direction of the Federal Communications Commission (FCC). See 47 C.F.R. §§ 54.701, 54.702. The USF monies are not appropriated federal funds; nonetheless, they exist by reason of a federal mandate. The funds are not distributed by a federal agency but by USAC, a private nonprofit corporation, subject to regulation. See generally Tex. Office of Pub. Util. Counsel v. FCC, 183 F.3d 393, 405-09 (5th Cir. 1999) (describing USF provisions of 1996 Telecom Act and subsequent regulations); R.F. Frieden, Universal Service, 13 Harv. J.L. & Tech. 395, 397-422 (2000) (same).

The E-Rate program implements the Telecom Act's mandate of USF support for schools. See 47 U.S.C. § 254(b)(6). In the past few years, USAC has disbursed between $ 1.4 billion and $ 1.7 billion annually in E-Rate funding for schools and libraries. To receive funds, a school enters directly into a contract with a service provider to supply eligible telecommunications services. See 47 C.F.R. § 54.504(c). The service provider must be registered with USAC. See USAC Service Provider Manual, ch. 4, available at http://www.sl.universalservice.org/vendor/manual/ (last visited May 15, 2003). A school must complete an application process with multiple steps to have E-Rate support approved. The amount of funding a school receives from the USF depends on the area's poverty level, and ranges from 20% to 90% of the total cost of eligible projects. See 47 C.F.R. § 54.505(b). Springfield, one of the state's most economically disadvantaged school districts, generally receives near the maximum percentage.

Most often, after approval, USAC and a school simply disburse their respective shares of the cost directly to the service provider. Sometimes, however, schools elect an alternative payment method, referred to as "Billed Entity Applicant Reimbursement" (BEAR), especially if they want a project completed quickly. Springfield chose the BEAR option for the two contracts at issue here. Under the BEAR method, a school (the "Billed Entity Applicant") pays the full cost to a service provider up front, receives from USAC a funding commitment letter for the E-Rate program's share of the cost, and then submits a form to USAC to receive reimbursement.

USAC makes its payments from the USF in the form of either a check or, if the service provider so chooses and owes charges to the USF, a credit against those charges.

See 47 U.S.C. § 254(h)(1)(B)(i)-(ii); 47 C.F.R. § 54.515. USAC says that it lacks the authority to pay a school directly, because the Telecom Act and its regulations allow payments from the USF only to service providers. See 47 U.S.C. § 254 (e) ("Only an eligible telecommunications carrier . . . shall be eligible to receive specific Federal universal service support"); id. § 254(h)(1)(B) (authorizing E-Rate payments for "telecommunications carriers"). Thus the service provider, who has already been paid, must receive the funds under the BEAR method and pass them through to the school. As part of the BEAR application, an authorized representative of the service provider is required to sign an "acknowledgment" that:The service provider must remit the discount amount authorized by [USAC] to the Billed Entity Applicant who prepared and submitted this [form] as soon as possible after [USAC]'s notification to the service provider of the amount of the approved discounts . . . but in no event later than 10 calendar days after the receipt of the reimbursement payment . . . .

The service provider must remit payment of the approved discount amount to the Billed Entity Applicant prior to tendering or making use of the payment issued by [USAC] to the service provider . . . . USAC's handbook for service providers is even more explicit: "The service provider functions merely as a vehicle to deliverthe reimbursement back to the applicant. Failure to provide the reimbursement in a timely fashion may result in the Service Provider facing enforcement action." USAC Service Provider Manual, supra, ch. 9. n1 Springfield says it normally received reimbursements within a few days after USAC paid them to the service provider.

LAN Tamers completed a number of projects for

Springfield, two of which are pertinent. In 1999, LAN Tamers and Springfield entered into a $ 1,096,180.28 contract for LAN Tamers to install a high-speed data network at Central High School. In 2001, they entered into a separate one-year contract for LAN Tamers to provide network maintenance services at four Springfield schools for $ 134,220. LAN Tamers completed both jobs satisfactorily. Springfield paid in full for the Central High School project by January 2000, and for the maintenance contract by January 2002.

USAC initially found the Central High School project ineligible for E-Rate funding, but Springfield appealed this decision to the FCC and prevailed in March 2001. By early 2002, the contracts were fully performed by both parties and Springfield had received funding commitment letters from USAC stating that the E-Rate program would reimburse 87% of each contract's cost. These two reimbursements total $ 1,070,056.74. Springfield submitted the required BEAR paperwork to USAC on April 17, 2002. On each form, LAN Tamers signed the acknowledgment quoted above.

A month later, on May 20, 2002, LAN Tamers filed a voluntary Chapter 11 bankruptcy petition. Upon learning of this filing, USAC withheld payment of the reimbursements, which were to have been made to LAN Tamers by check. At proceedings brought by creditors, LAN Tamers mentioned the reimbursements and said the monies were not its property and that it acted merely as a pass-through. The creditors claimed the proceeds. The City of Springfield appeared and asserted the reimbursements were its property. The bankruptcy court opined that Springfield's claim was really a claim to title and to recover an asset and so it should be asserted in an adversary proceeding. See Fed. R. Bankr. P. 7001(2). n2

On June 4, 2002, Springfield filed an adversary proceeding laying claim to the reimbursements. The suit named as defendants LAN Tamers, its principal creditors, and USAC. One creditor, the Bank of Western Massachusetts, counterclaimed, arguing that its secured interest in all receivables of LAN Tamers extended to the reimbursements. The Official Unsecured Creditors' Committee also argued against Springfield's position and was deemed a party to the proceeding. LAN Tamers supported Springfield's claim. USAC also argued that the reimbursements belonged to Springfield rather than LAN Tamers, but differed as to exactly what power the bankruptcy court had over USAC to order it to take action. Presumably, with the blessing of the bankruptcy court's determination that the funds belong to Springfield, USAC intends to make a check payable to LAN Tamers for the funds to be paid out to Springfield. n3 The bankruptcy court took testimony in the adversary proceeding on June 13, 2002, and heard post-trial oral argument on June 26. It also received pre-trial and post-trial briefing from the parties.

The bankruptcy court issued a comprehensive written decision in the adversary proceeding on August 16, 2002. City of Springfield v. LAN Tamers, Inc. (In re LAN Tamers, Inc.), 281 B.R. 782 (Bankr. D. Mass. 2002). It determined that the reimbursements were not the property of the estate, but were held by LAN Tamers in either a resulting trust or a constructive trust for the benefit of Springfield. Id. at 792, 796-97. The district court affirmed this decision in a one-page order on September 26.

In October 2002, the bankruptcy court converted LAN Tamers' petition from Chapter 11 to Chapter 7 and appointed David W. Ostrander as trustee of the bankruptcy estate. The trustee replaced the creditors'

committee as the appellant before this court. He appeals the exclusion of the reimbursements from the property of the estate.

II.

The only issue here, whether the reimbursements are the property of the estate, is purely one of law. Normally, such issues are reviewed de novo. See Lentz v. Spadoni (In re Spadoni), 316 F.3d 56, 58 (1st Cir. 2003); Adams v. Coveney, 162 F.3d 23, 25 (1st Cir. 1998). Springfield argues for a more deferential standard, citing a case concerning a bankruptcy court's award of fees, Prebor v. Collins (In re I Don't Trust), 143 F.3d 1, 3 (1st Cir. 1998) (per curiam). That case is inapposite, because it invoked discretionary and fact-based judgments made by the bankruptcy judge. Id.; see Casco N. Bank, N.A. v. DN Assocs. (In re DN Assocs.), 3 F.3d 512, 515 (1st Cir. 1993). Here, there is plenary review of an unalloyed legal question. We have jurisdiction over the appeal because the ruling is a final disposition of Springfield's adversary action.

Section 541 of the Bankruptcy Code defines the property of the estate. See 11 U.S.C. § 541 (2000). The statutory language evinces congressional intent to include a broad range of property. See United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05, 76 L. Ed. 2d 515, 103 S. Ct. 2309 (1983). It begins, in § 541(a), by including "all legal or equitable interests of the debtor in property." 11 U.S.C. § 541(a)(1). The remainder of § 541, however, enumerates statutory exclusions from this broad definition. Property covered by these provisions is "excluded" from the estate, rather than being "exempted" under other portions of the Code. This is an important distinction. See Traina v. Sewell (In re Sewell), 180 F.3d 707, 710 (5th Cir. 1999) (differentiating

"exclusions" from "exemptions"); Ostrander v. Lalchandani (In re Lalchandani), 279 B.R. 880, 882 n.3 (B.A.P. 1st Cir. 2002) ("Property must first be property of the estate before it can be exempted.").

Two exclusions are arguably relevant here. One such exclusion, § 541(c)(2), removes inalienable interests in trusts, typically spendthrift trusts or pension plans, from the estate. The bankruptcy court rested its holding on another basis for exclusion, which states:Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold. 11 U.S.C. § 541(d).

The trustee argues that the reimbursements are accounts receivable of LAN Tamers, covered by the broad definition of the property of the estate, and that Springfield is an ordinary unsecured creditor of LAN Tamers, entitled only to a pro rata distribution for its claim on an unpaid contractual debt. Springfield, pointing to the bankruptcy court decision and the language of the § 541(d) exclusion, responds that LAN Tamers never had any equitable interest in the reimbursements and was simply a conduit for them. There is no claim that Springfield did not meet all the requirements to get the funding; USAC, in whose coffers the funds now reside, argues that the money should go to Springfield. Cf. Buchanan v. Alexander, 45 U.S. (4 How.) 20, 11 L. Ed. 857 (1846) (navy purser argues that seamen's wages cannot be attached by their creditors).

The plain text of § 541(d) excludes property from the estate where the bankrupt entity is only a delivery vehicle and lacks any equitable interest in the property it

delivers. Identical language found in both the House and Senate reports that accompanied passage of the Bankruptcy Code strongly reinforces this plain reading. See United States v. Yellin (In re Weinstein), 272 F.3d 39, 43, 45-46 (1st Cir. 2001) (further supporting plain-text interpretation of Bankruptcy Code through legislative history). While noting that the overall scope of § 541 is broad, the reports continue: Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in a constructive trust for the person to whom the bill was owed. S. Rep. No. 95-989 (1978), at 82, reprinted in 1978 U.S.C.C.A.N. 5787, 5868; H.R. Rep. No. 95-595 (1978), at 368, reprinted in 1978 U.S.C.C.A.N. 5963, 6324. In this congressional hypothetical, property is excluded from the estate where the debtor merely receives property in order to deliver it to its intended recipient without any control or ownership over it.

The task, then, is to characterize the reimbursements properly. To determine the nature of LAN Tamers' interest, we look to the nature of the federal program from which that interest arises. At least two circuits have faced analogous problems under § 541(d). In one of these cases, the Seventh Circuit aptly framed the issue:The answer depends on the terms under which the grants were made. Did they constitute [the debtor] a trustee, custodian, or other intermediary, who lacks beneficial title and is merely an agent for the disbursal of funds belonging to another? If so, the funds . . . were not assets of the bankruptcy estate. Or were the grants

more like payment under a contract . . . ? In re Joliet-Will County Cmty. Action Agency, 847 F.2d 430, 432 (7th Cir. 1988) (Posner, J.) (citations omitted). Joliet-Will involved efforts by a federal agency to claim the unexpended balance of federal grant funds and property bought with grant funds from the estate of a bankrupt private nonprofit community service agency, and thus to prevent distribution of this property to creditors. The court looked at the nature of the federal government's interest in the property, expressed through the regulations and the nature of the grantor-grantee relationship. Id. at 432. Joliet-Will expressly noted that this federal interest does not preempt the Code – a recipient of federal money can declare bankruptcy – but it may affect the issue of who owns the property. Id. at 433.

The Third Circuit, in deciding In re Columbia Gas Systems, Inc., 997 F.2d 1039 (3d Cir. 1993), held that refunds created and mandated pursuant to federal law by a federal agency, the Federal Energy Regulatory Commission (FERC), and held by a bankrupt natural gas pipeline company, were not the property of the estate under § 541(d). Id. at 1061 (debtor "acts as a receiving and transmitting agent, or a conduit, for money upstream suppliers owe to overcharged consumers") (quotation omitted). As such, the funds could not be reached by creditors of the bankrupt entity. Analyzing the problem as one of federal law, Columbia Gas held that the bankruptcy court should give permission to the debtor to pay refunds that it had collected from upstream suppliers to the appropriate customers. Id. at 1064. Using trust and beneficiary concepts as a matter of federal common law, the court considered the facts that the refunds were created by order of a federal agency, private parties could not alter the refund orders, the refunds implemented a central objective of the federal

legislation, and the refunds should not be subject to the inconsistent results that the vagaries of state law would impose. Id. at 1055. Columbia Gas likewise excluded surcharges the debtor had collected from customers to fund industry research under FERC's direction. Id. at 1062; see also Westmoreland Human Opportunities, Inc. v. Walsh, 246 F.3d 233, 243-46 (3d Cir. 2001) (rights to debtor grantee's continuing contract relationship with government are not property of the estate); In re United Milk Prods. Co., 261 F. Supp. 766 (N.D. Ill. 1966) (funds collected by debtor under federal milk marketing orders, and owed to milk producers, are not property of the estate in pre-Code case); cf. Yonkers Bd. of Educ. v. Richmond Children's Ctr., 58 B.R. 980, 981-82 (S.D.N.Y. 1986) (funds from state education department paid to debtor but designated as "pass- through" payment for school district are not property of the estate).

These cases share several common modes of analysis which we apply here. First, we look to the role that the debtor was intended to play. In the words of USAC's guidance to service providers, LAN Tamers "functioned merely as a vehicle to deliver the reimbursement back to the applicant." Courts have classified debtors as mere delivery vehicles even when the nature of the "pass-through" under a government program is less obvious than it is here. n4 See Joliet-Will, 847 F.2d at 432; In re Community Assocs. Inc. , 173 B.R. 824, 830 (D. Conn. 1994) (vans purchased with state-administered federal grant for transport of elderly and disabled are not property of the estate). Joliet- Will emphasized that the terms of the grant rendered the grantee "in effect an agent to carry out specified tasks rather than a borrower, or an entrepreneur using invested funds." 847 F.2d at 432. The restrictive rules and intensive oversight rendered the grantee's owner ship "nominal." Id.; see also In re Cmty. Assocs., 173 B.R. at 828-29 (applying

similar analysis to restrictive grant agreement). There is little doubt in this case that the regulatory structure of the E-Rate program reduced LAN Tamers to the status of a mere delivery vehicle. LAN Tamers signed an acknowledgment stating as much and foregoing any beneficial interest in the funds. USAC's guidance reiterates the point forcefully.

Second, we look to the degree and intensity of regulatory control over the property in question. See, e.g., Westmoreland, 246 F.3d at 244-46 (looking to agency's "pervasive and rigorous" administration of grant); Joliet-Will, 847 F.2d at 432 (noting that federal agency placed "minute controls on the use of the funds" by debtor grantee). As stringent as the supervision was in cases such as Joliet-Will, the debtor there enjoyed at least some autonomy in the use of the property at issue. Not so here. Under the BEAR payment method, LAN Tamers has absolutely no freedom to do anything with the reimbursements except forward them to Springfield within ten days. LAN Tamers was explicitly barred from "tendering or making use of" the payment from USAC before Springfield was reimbursed. In addition, other aspects of the E-Rate program, including the registration of service providers and the multi- layered approval process for projects, display a comparable or greater degree of regulatory control.

Next, we focus on the extent to which recognizing a greater ownership interest – and thereby diverting the property in question to the creditors – would thwart the overall purpose of the regulatory scheme. See, e.g., Columbia Gas, 997 F.2d at 1055 ("The refunds arise directly from federal law and implement the central objective of the [Natural Gas Act]."); Yonkers, 58 B.R. at 983 (purpose of reimbursement structure was to provide free public education to mentally disabled children). In

part, the amount of oversight is a proxy for this consideration. See Westmoreland, 246 F.3d at 244. But even without reference to the detailed BEAR procedures, it is clear that Congress intended money from the USF to pay only for certain very specific activities. See 47 U.S.C. § 254(e) (USF funds shall be used "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended"). LAN Tamers has already been paid for the eligible services it provided; allowing USF funds to pay its other debts would violate this congressional mandate. See Buchanan, 45 U.S. at 20-21 ("The funds of the government are specifically appropriated to certain national objects, and if such appropriations may be diverted and defeated by state process or otherwise, the functions of the government may be suspended."); Joliet-Will, 847 F.2d at 432 ("Congress is traditionally chary" of allowing funds of government programs to be diverted from their stated purposes).

Finally, we note that this conclusion also prevents the creditors from receiving a windfall of double payment for the work LAN Tamers completed in Springfield's schools. If LAN Tamers had not filed for bankruptcy, it could hardly sue USAC in its own right to be paid again, having received full payment for its services from Springfield long before. Once USAC issued the check to LAN Tamers, the company could not have diverted the funds to its creditors or to other purposes without "facing enforcement action." At most, LAN Tamers arguably would hold bare legal title to the reimbursements for a short time. n5 It is a fundamental principle of bankruptcy law "that the estate can only succeed to the same property interest that the debtor possesses, and cannot achieve a greater interest." 5 L.P. King et al., Collier on Bankruptcy P 541.01, at p. 541-8

(15th ed. 2003) (discussing § 541(d)). A conclusion that the reimbursements should be distributed to the creditors would flout this basic premise. It would provide a windfall to the creditors at the expense of Springfield's public schools and its students, contrary to the dictates of the statutory and regulatory text underlying the E-Rate program.

III.

The trustee seeks to undermine this conclusion in a variety of ways. He advances different characterizations of many of the cases cited above, but the factual distinctions he makes are immaterial to the legal conclusions we draw from the cases.

The trustee devotes most of his energy to supporting a very narrow interpretation of § 541(d). He argues that it applies solely to trusts that would be recognized under state law, in this case Massachusetts law. He further argues that the conditions of Massachusetts trust law are not satisfied here. We need not determine if the second contention is correct, because we reject the first. There is no basis for a per se rule limiting § 541(d) to state law trusts under all circumstances.

The Supreme Court unanimously rejected such a "state law only" interpretation in Patterson v. Shumate, 504 U.S. 753, 119 L. Ed. 2d 519, 112 S. Ct. 2242 (1992). That case concerned the exclusion in § 541(c)(2): "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under [the Bankruptcy Code]." A beneficiary of a pension plan that was covered by the antialienation provision of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1056(d)(1) (1988), claimed that his interest in

the plan was excluded from his bankruptcy estate because ERISA served as "applicable nonbankruptcy law" restricting its transfer. The Patterson Court rejected an argument that the phrase applies only to state law, and not ERISA, finding that interpretation contrary to a "natural reading of the provision." 504 U.S. at 758; see Lalchandani, 279 B.R. at 885-86 (applying ERISA to § 541(c)(2) case concerning dependents of beneficiaries).

The Court also noted that, when Congress intended for bankruptcy questions to be answered only by reference to state law, it so specified. Patterson, 504 U.S. at 758 (citing examples). For example, the Code explicitly incorporates applicable state law in defining certain exemptions. See 11 U.S.C. § 522(b); Howe v. Richardson, 193 F.3d 60, 61 (1st Cir. 1999) (applying Rhode Island law to exemption under § 522(b)(2)(A)). In the absence of any language specifically incorporating state law in the exclusions, the "natural reading" of § 541(d), like the Patterson Court's reading of § 541(c)(2), cuts against the trustee's proposed construction that it incorporates and is restricted by state law in all situations.

It is true that state law often provides the applicable rules for bankruptcy determinations in the absence of other imperatives. As the Supreme Court has summarized it, "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently [in bankruptcy law]." Butner v. United States, 440 U.S. 48, 55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979) (emphasis added); see Barnhill v. Johnson, 503 U.S. 393, 398, 118 L. Ed. 2d 39, 112 S. Ct. 1386 (1992) (citing Butner). Likewise, a recent bankruptcy decision in this court noted that a federal court "will often simply incorporate the law of the

appropriate state if there is no relevant federal interest to justify a distinct federal rule." United States v. Fleet Bank of Mass. (In re Calore Express Co.), 288 F.3d 22, 44 (1st Cir. 2002) (emphasis added); see also Conn. Gen. Life Ins. Co. v. Universal Ins. Co., 838 F.2d 612, 618 (1st Cir. 1988) (state law "usually" the determinant of property interests). In short, "Section 541 eliminates exclusive reliance on state law in determining what constitutes property of the estate but recognizes the traditional role of the states in creating and defining the underlying property interests and commercial arrangements to which bankruptcy law applies." Branch v. Hill, Holliday, Connors, Cosmopolous, Inc. (In re Bank of New Engl. Corp.), 165 B.R. 972, 977 (Bankr. D. Mass. 1994) (quotation omitted).

The qualifying clauses in these decisions cannot be ignored. Where there are significant federal interests involved, the default rule of applying state standards to bankruptcy determinations may yield. n6 Here, the statutory and regulatory framework for the E-Rate program, established under the Telecom Act, provides a federal definition of the property interests involved in this case. That definition takes account of the federal government's aspiration, expressed in the Telecom Act and promoted by the activities of the FCC and USAC, that "elementary and secondary schools and classrooms . . . should have access to advanced telecommunications services." 47 U.S.C. § 254(b)(6). As such, it is the definition that we apply. See Calore Express, 288 F.3d at 43-44 (choice of standard guided by protection of strong federal interests).

Just as the language of § 541(d) does not invariably incorporate state law, it is not always limited to trusts either. To be sure, since the separation of legal and equitable interests is characteristic of a trust, there will

be overlap. In some of the cases discussed above, courts classified the excluded property as the corpus of a trust of some kind. E.g., Columbia Gas, 997 F.2d at 1059-60; Yonkers, 58 B.R. at 983. The bankruptcy court here did so as well. LAN Tamers, 281 B.R. at 792. And Congress referred to a "constructive trust" in the insurance hypothetical quoted earlier.

This usage may prove confusing, however, because these supposed trusts might lack characteristics of trusts recognized for other purposes under state law. We think it better to avoid the language of trusts and rest our holding more simply on the fact that LAN Tamers, as a mere delivery vehicle, lacked an equitable interest in the reimbursements under the federal program. n7 See R.J. Keach, The Continued Unsettled State of Constructive Trusts in Bankruptcy, 103 Com. L.J. 411, 446, 449 n.172 (1998) (distinguishing "true conduit" cases from constructive trust cases); cf. Joliet-Will, 847 F.2d at 433 (criticizing characterization of government's interest in debtor's grant funds as "equitable lien" for similar reasons).

The trustee also argues that the Supreme Court's recent decision in FCC v. NextWave Personal Communications, Inc., 537 U.S. 293, 154 L. Ed. 2d 863, 123 S. Ct. 832 (2003), requires a different outcome. In NextWave, the debtor had purchased broadband spectrum licenses in an FCC auction, and arranged to pay for them in installments. When the debtor fell behind in its payments and filed for bankruptcy, the FCC tried to revoke the licenses, but the Court held that it could not. The licenses remained property of the estate.

There are two enormous differences between NextWave and this case. First, FCC licenses have many qualities of property in which the licensee holds beneficial interest,

sweeping them out of the § 541(d) exclusion and into the broad overall definition of property of the estate. See Ramsay v. Dowden, (In re Cent. Ark. Broad. Co.), 68 F.3d 213, 214-15 (8th Cir. 1995) (per curiam). The licensee secures the right to engage in communications activities and keep the resulting profit for itself – rather than serving solely as a vehicle delivering benefits to another – and does so under less pervasive regulatory supervision. See Westmoreland, 246 F.3d at 253-54 (distinguishing broadcast licenses from contract rights under a grant).

A second distinction between this case and NextWave is that NextWave relied heavily on specific language in the Bankruptcy Code barring the government from revoking a license on the basis of a debtor's nonpayment. See 11 U.S.C. § 525(a). The Court rejected the FCC's argument that its regulatory authority trumped this prohibition. NextWave, 123 S. Ct. at 838-40. As such, it invalidated the purported revocation as "not in accordance with law" under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2000). See NextWave, 123 S. Ct. at 838. Here, in contrast, the trustee points to no similar provision of the Code that applies to the reimbursements and stands in opposition to the federal rules derived from the E-Rate program's regulatory scheme.

Finally, throughout his briefs the trustee emphasizes the importance in bankruptcy law of equal footing for similarly placed creditors. The argument assumes that Springfield is indeed a creditor similar to the others. This bankruptcy policy is not implicated, however, when the property in question is not legitimately available to creditors in the first place. See Begier v. IRS, 496 U.S. 53, 58, 110 L. Ed. 2d 46, 110 S. Ct. 2258 (1990) (policy behind avoidance irrelevant when property is not part of the estate); United Milk, 261 F. Supp. at 768 ("Unsecured

creditors should not be permitted to share in monies . . . which [the debtor] would not be permitted to retain for its own use."). The true harm to creditors is minimal here anyway, because the legal and regulatory impediment to using the reimbursements for other purposes makes bare legal title to them an asset of almost no value. See Westmoreland, 246 F.3d at 244 (restrictions on housing grants so limit their transferability that grantee's interest is "essentially valueless"). LAN Tamers served only as a delivery vehicle for federally regulated reimbursements derived from the USF, not as an owner of those funds (or of the right to receive them). The reimbursements were never part of the bankruptcy estate, so creditors never had a claim to them.

IV.

For the reasons stated in this opinion, the ruling of the district court is affirmed.

FOOTNOTES

n1 We have found nothing further as to what "enforcement action" means, and whether it encompasses, for example, a prosecution for theft of the money. Cf. United States v. McKay, 274 F.3d 755, 759 (2d Cir. 2001) (affirming conviction under 18 U.S.C. § 641 (2000) for embezzling "money . . . of the United States" where defendant improperly collected federally funded rent subsidy from local housing authority).

n2 No party disagrees that this is the appropriate vehicle to sort through the claim.

n3 Springfield also asked the bankruptcy court to order USAC to remit the reimbursements within a certain

time. The court concluded it had no jurisdiction to do so, City of Springfield v. LAN Tamers, Inc. (In re LAN Tamers, Inc.), 281 B.R. 782, 797-98 (Bankr. D. Mass. 2002), and the issue is not before us. USAC has filed an amicus brief in support of Springfield in this appeal.

n4 Some courts have excluded property from the estate on the basis that the debtor was a mere delivery vehicle without any government interest directly at stake. See, e.g., T & B Scottdale Contractors, Inc. v. United States, 866 F.2d 1372, 1376 (11th Cir. 1989) (bank account maintained by primary contractor contained funds from subcontractor to pay its materialmen; funds not part of subcontractor's bankruptcy estate because held solely for benefit of materialmen); Branch v. Hill, Holliday, Connors, Cosmopolous, Inc. (In re Bank of New Engl. Corp.), 165 B.R. 972, 978 (Bankr. D. Mass. 1994) (debtor transmitted payments from its subsidiaries to an advertising agency; this was "straight pass-through" with "no profit element" for debtor and therefore not property of its estate); Shipley Co. v. Darr (In re Tap, Inc.), 52 B.R. 271, 276 (Bankr. D. Mass. 1985) (debtor payroll company's "only function was to transmit the funds entrusted to it promptly" so that funds are not property of its estate). We need not consider such non-governmental situations in this appeal.

n5 For purposes of this opinion, we need not consider whether the bankruptcy court was correct in determining that LAN Tamers did hold legal title to the reimbursements, despite the fact that USAC has never sent the check. See LAN Tamers, 281 B.R. at 792.

n6 We need not decide precisely when state law would or would not apply. We simply conclude that this situation involves sufficiently significant federal interests.

n7 In addition, the use of constructive trusts as the basis for exclusions under § 541 has been criticized for reasons unrelated to the situation of the true delivery vehicle. See generally XL/Datacomp, Inc. v. Wilson (In re Omegas Group), Inc.), 16 F.3d 1443 (6th Cir. 1994); E.L. Sherwin, Constructive Trusts in Bankruptcy, 1989 U. Ill. L. Rev. 297.

No. 02-4194
Chapter 11, Case No. 02-43147, Adversary Proceeding

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MASSACHUSETTS

In re: LAN TAMERS, INC.,
Debtor;

CITY OF SPRINGFIELD,
Plaintiff

v.

LAN TAMERS, INC., THE BANK OF WESTERN MASSACHUSETTS, EDUCATIONAL TECHNOLOGY, INC., and UNIVERSAL SERVICE ADMINISTRATIVE COMPANY,
Defendants

August 16, 2002, Decided
August 16, 2002, Entered on Docket

COUNSEL: For The City of Springfield: Joseph B. Collins, Hendel & Collins, P.C., Springfield, MA.

For Lan Tamers, Inc.: Martin O'Connell, Morisi & O'Connell, Springfield, MA.

For The Bank of Western Massachusetts: Jerry B. Plumb, O'Connell & Plumb, P.C., Springfield, MA.

For Educational Technology, Inc.: Mark H. Bluver, Shatz, Schwartz & Fentin, P.C., Springfield, MA.

For Universal Service Administrative Company: Amanda C. Ellis, Mirrick O'Connell, DeMallie & Lougee, LLP, Worcester, MA.

JUDGES: Henry J. Boroff, United States Bankruptcy Judge.

OPINIONBY: Henry J. Boroff

OPINION:

MEMORANDUM OF DECISION

Before the Court is a complaint filed by the City of Springfield (the "City") against Lan Tamers, Inc. (the "Debtor"), the Bank of Western Massachusetts (the "Bank"), Educational Technology, Inc. ("ETI") (collectively "the Creditors") and the Universal Service Administrative Company ("USAC"). The Complaint seeks, inter alia, a declaration that certain reimbursement funds to be paid to the Debtor by USAC for work performed on the City's behalf are not property of the estate, but rather the property of the City.

A trial on this matter was held on June 13, 2002. No material facts are really in dispute. n1 The question is not how much is owed, but instead who owns the proceeds of the federal grant administered by USAC- the Debtor (and the estate) or the City. For the reasons set forth below, the Court rules that the Debtor holds the promised federal reimbursement in resulting trust for the benefit of the City. Alternatively, the Court rules that the Debtor holds the grant under a constructive trust for the City. Accordingly, those funds, when received, shall not constitute property of the Debtor's bankruptcy estate.

I. FACTS

The Universal Service Fund (the "Fund") is a funding mechanism mandated and expanded under the federal Telecommunications Act of 1996, 47 U.S.C. § 254 (2002), (the "Act"). The fund is generated through mandatory contributions from "all telecommunications companies in the United States, including all local and long distance telephone companies, wireless and paging companies and payphone providers." Stipulation at P19; 47 U.S.C. § 254(d). The Act's central purpose is to "ensure that health care providers for rural areas, elementary and secondary school classrooms, and libraries have affordable access to modern telecommunications services . . .." Texas Pub. Util. Counsel v. FCC, 183 F.3d 393, 441 (5th Cir. 1999) (quoting H.R. Rep. 104-458, at 132 (1996), reprinted in 1996 U.S.C.A.A.N. at 124, 144).

Among the Act's various goals is the support of telecommunications services, networking and internet access for schools and libraries. This support, denominated the E-rate discount, is offered either by requiring that service providers who are mandatory contributors to the Fund confer discounts to applicants or by providing applicants with reimbursement from the Fund when other qualified service providers are used. 47 U.S.C. § 254(h)(B); n2 47 C.F.R. § 54.501 (2002). The level of E-rate discounts or reimbursements is largely dependent on the economic condition of the target area. In areas of lower income, the discount or reimbursement is higher; in areas of higher income, the discount or reimbursement is lower. 47 C.F.R. § 54.505 (2002).

A. Universal Service Fund Reimbursement Mechanism

The Fund is administered by USAC, a non-profit corporation, under the auspices of the Federal Communications Commission ("FCC"). 47 C.F.R. § 54.702 (2002). The procedures for applying for reimbursement are set forth in the FCC's regulations and the USAC manual. See 47 C.F.R. § 54.504 (2002); USAC application procedure guide, available at http://www.sl.universalservice.org/apply/.

A qualifying entity seeking discounted service for improvements in the telecommunications capability of a school or library begins by obtaining approval by USAC's Schools and Libraries Division (the "SLD"). After a competitive bidding process, the applicant must submit an application detailing the nature and scope of the project. 47 C.F.R. § 54.504(a),(b). Upon obtaining initial approval, a contract is signed with the chosen service provider and a final application submitted, specifying the method of payment. 47 C.F.R. § 54.504(c). USAC's SLD then conducts a further review, and determines whether a funding commitment letter will be issued.

If the project is accepted, and reimbursement from the Fund is required and available, two alternative methods of payment for the project are permitted under the regulations. Under the most commonly used method, the Service Provider ("SPI") method, the applicant pays only its discounted share to the service provider; the balance of the invoice is paid or credited to the service provider by USAC. However, situations occasionally arise where the SPI method of payment is impractical. For example, if the project is accepted by USAC but not yet funded, the applicant may wish to go forward without delay and await the funding by way of

reimbursement. The SPI payment method may also be impractical if project approval is actually denied by USAC and the applicant wishes to appeal to the FCC, but go forward with the project in the interim and undertake the risk that its position is not upheld. In such cases, applicants may choose the Billed Entity Reimbursement ("BEAR") method of payment.

Under the BEAR method, the applicant pays all of the vendor's invoice in advance. See Form 472 (BEAR) Filing Guidance, available at http://www.sl.universalservice.org/reference/8bear.asp. When and if a USAC funding commitment letter is later obtained, the service provider may then bill USAC for the reimbursement. Upon receipt of the funds, the service provider must promptly remit that sum to the applicant. Id.

Regardless of the method of payment chosen, reimbursement checks are made payable to the order of the service provider. USAC/SLD Service Provider Manual, Chapter 9 at 2-3, available at http://www.sl.universalservice.org/vendor/manual/chapter9.doc. n3 Where the service provider enters into E-rate contracts with several applicants, a single reimbursement check is issued for the total amount owed under all of its contracts. Id. From this total amount, the service provider must then calculate the corresponding amount to be passed through to applicants who have chosen the BEAR payment method. Id.

USAC's reimbursement procedures unequivocally state that where the BEAR payment method applies, the service provider acquires no rights of ownership in the proceeds of the reimbursement. Indeed, in order to obtain the reimbursement, the applicant must submit

FCC (BEAR) Form 472, which contains the following required acknowledgment by the service provider's authorized representative:

I am authorized to submit this Service Provider Acknowledgment for this Billed Entity Applicant Reimbursement Form, and acknowledge to the best of my knowledge, information and belief as follows:

I. The service provider must remit the discount amount authorized by the fund administrator to the Billed Entity Applicant who prepared and submitted this Billed Entity Applicant Reimbursement Form as soon as possible after the fund administrator's notification to the service provider of the amount of the approved discounts on this Billed Entity Applicant Reimbursement Form, but in no event later than 10 calendar days after receipt of the reimbursement payment from the fund administrator, subject to the restriction set forth in B. below.

II. The service provider must remit payment of the approved discount amount to the Billed Entity Applicant prior to the tendering or making use of the payment issued by the Universal Service Administrative Company to the service provider of the approved discounts for the Billed Entity Applicant Reimbursement Form.

FCC (BEAR) Form 472, Block 4, available at http://www.sl.universalservice.org/form/#vendor.

Furthermore, in the USAC Service Provider Manual, the following language appears as specific guidance to service providers:

Although the BEAR form is essentially an Applicant Form, it does require a signature from the Service Provider in Block 4. The purpose of this signature is to

ensure that the Service provider is aware of the requirement that the Service Provider turn over the BEAR reimbursement amount (to the applicant) within 10 days of receipt of the check. The Service provider functions merely as a vehicle to deliver the reimbursement back to the applicant. Failure to provide the reimbursement in a timely fashion may result in the Service Provider facing enforcement action.

USAC/SLD Serv. Prov. Manual, Ch. 9 at 1, (emphasis supplied).

B. The City's Application Process

On April 1, 1999, the Debtor entered into a contract with the City to furnish and install certain network wiring in the City's Central High School (the "Central High School Project"), for the total price of $ 1,096,180.28. The work was performed and the Debtor was paid in full by the City. The City also entered into a separate contract with the Debtor in early 2001 to deliver certain network maintenance services for a one (1) year period to four other of the City's schools (the "Network Maintenance Project"), for a total price of $ 134,000.00. The Debtor completed the work, and was paid in full by the City.

Prior to the commencement of the Central High School Project, application was made to USAC for project approval from the Universal Service Fund. USAC declined for reasons not relevant here. The City appealed USAC's adverse determination to the FCC, but proceeded with the project in the interim. Ultimately, the City prevailed by order of the FCC, dated March 5, 2001. By letter of January 18, 2002, USAC acknowledged that, based on the FCC's action, USAC would reprocess the City's request for reimbursement from the Universal Service Fund and would issue a funding commitment

letter. USAC's funding commitment letter, authorizing a reimbursement of 87%, or $ 953,285.34, followed on April 12, 2002. n4

The Network Maintenance Project took a different path. Here, when application was made, USAC approval was given, but USAC did not then provide a funding commitment. As was the case with the Central High School Project, the City could not wait and moved ahead, paying the Debtor up front for its services. The USAC funding commitment finally arrived on February 8, 2002 in the amount of $ 116,771.40, or 87% of the amount that the City had already paid to the Debtor.

With funding commitments from USAC in hand, the City, on April 17, 2002, filed its respective Forms 486 (certifying, inter alia, that the services from the Debtor had indeed been received) and respective BEAR forms for the Central High School and Network Maintenance Projects. Accordingly, the City sought from USAC reimbursements in the amounts of $ 953,285.34 for the Central High School Project and $ 116,771.40 for the Network Maintenance Project, for a total $ 1,070,056.74 (the "Reimbursements").

In accordance with USAC procedural requirements, the BEAR forms were executed by both the City and the Debtor. Payment would be made to the Debtor service provider, subject to the signed certification made by the Debtor's authorized representative in Block 4 of the BEAR application form submitted. Thus, pursuant to the terms of the BEAR form (its overly clumsy language aside), the Debtor was obligated to remit the funds received from USAC to the City as soon as possible after receipt, and certainly no later than 10 calendar days thereafter. Further, under no circumstances was the Debtor permitted to employ those funds for its own use.

On May 20, 2002, after the City's submission of the BEAR forms, but before the Debtor's receipt of funds from USAC, the Debtor filed a Petition in this Court under Chapter 11 of the Bankruptcy Code. The Chapter 11 case was filed to forestall injunctive relief sought by ETI, a substantial unsecured creditor, in the United States District Court for the District of Massachusetts.

Shortly after the case filing, the Debtor sought leave from this Court to use the cash collateral of the Bank of Western Massachusetts (the "Bank"), pursuant to 11 U.S.C. § 363(2)(B). The Bank claimed to hold a security interest in substantially all of the Debtor's assets, including its receivables, to secure payment of approximately $ 300,000.00. In conjunction with the first interim hearing on the Debtor's request to use the Bank's cash collateral, held on May 23, 2002, the Debtor first mentioned the Reimbursements, but conceded that the monies due were not property of the Debtor. The Debtor characterized itself as a "pass-through" of the funds from USAC to the City. The Bank and ETI disagreed. However, in light of the fact that the secured position of the Bank appeared adequately protected in assets of the Debtor excluding consideration of the Reimbursements, the Court granted interim cash collateral use. The hearing on interim cash collateral authorization was then continued to May 29, 2002 for reasons not relevant here.

On May 29, 2002, the City appeared at the continued cash collateral hearing. It forcefully asserted its claim to the Reimbursements, arguing that they were property of the City and not of the estate. Again, the Bank and ETI, now joined by the unsecured creditors committee, disagreed. The Bank and the Debtor presented the Court with a Stipulation between them under which the Bank would agree to the Debtor's use of cash collateral and

acquire a roll-over lien. The Stipulation did not dispose of the Reimbursements question. The Court granted the Stipulation, as amended in form requested by the Court, but further ordered the Debtor not to use the proceeds of the Reimbursements, absent further court order. As for the City's claim of right to the Reimbursements, the Court opined that the City's claim was really a claim of title to (and to recover) an asset, and, therefore, should be asserted by way of an adversary proceeding. See Fed. R. Bankr. P. 7001(2).

The instant adversary proceeding was filed by the City on June 4, 2002, naming as defendants the Debtor, the Bank, ETI and USAC. The City's Complaint requests that the Court rule that the Reimbursements are not property of the estate, but property of the City, free and clear of any claim of the Bank or ETI. The Complaint also requests that the Court order USAC to remit payment to the City by a time certain. In addition, the Bank has counterclaimed, asking the Court to determine that it has a perfected security interest in the Reimbursements.

II THE POSITIONS OF THE PARTIES

The City begins with a simple proposition. It contends that the Reimbursements are not, and never were, property of the Debtor. The Debtor was paid in full by the City. Although USAC regulations require that USAC remit the funds initially to the service provider, the Debtor was never entitled to retain those funds or use them for its own purposes and was under a duty to remit promptly to the City. The City maintains that regardless of whether the Debtor had a legal interest in the Reimbursements, the Debtor had no equitable interest therein. Accordingly, pursuant to 11 U.S.C. § 541(d), the Reimbursements are not property of the estate. The City argues further that, even if § 541(d) were not

applicable, it would prevail under theories of express, constructive trust or resulting trust, each of which is recognized under Massachusetts law. The Debtor essentially agrees with the positions taken by the City.

The Creditors disagree. n5 They argue that the Reimbursements are nothing more than accounts receivable owed by USAC to the Debtor, and the obligation of the Debtor to the City is nothing more than a contract claim held by the City. The Creditors contend that the BEAR form created no fiduciary relationship, and, if it did, neither the FCC nor USAC had the statutory or regulatory authority to create such a relationship.

Absent a statutory or technical trust, the Creditors maintain, no express trust relationship can be created. As for the constructive trust theory advanced by the City, the Creditors contend that such an equitable remedy requires that the City establish both a legal right or interest in the Reimbursements and a fiduciary duty owed by the Debtor. They assert that neither exists, and that, even if the City were able to establish itself as a constructive trust beneficiary, its rights would be subject to the those of the Bank (as a bona fide purchaser) and no greater than any other unsecured claimant. Finally, the Creditors argue that the City's position, if upheld, would subvert fundamental notions of creditor equality that constitute underlying policies of the Bankruptcy Code.

USAC agrees with the City . . . to a point. USAC agrees that the Reimbursements are not property of the estate. It notes, however, that once the Court has made that determination, the remaining parties in interest are the City and USAC, both non-debtors. The Court is then, USAC maintains, without subject matter jurisdiction

under 28 U.S.C. § 1334 to require USAC to make the payment to the City on any time frame other than that chosen by USAC.

III. DISCUSSION

In order to determine whether the Reimbursements are part of the bankruptcy estate's pool of assets, this Court turns first to the provisions of § 541 of the Bankruptcy Code. That section provides that upon the commencement of a bankruptcy case, an estate is created comprised of "all legal or equitable interests of the debtor . . . wherever located and by whomever held." 11 U.S.C. § 541(a) (2002). It is well established that the scope of property to be included under § 541(a) is broad. United States v. Whiting Pools, Inc., 462 U.S. 198, 204, 103 S. Ct. 2309, 2313, 76 L. Ed. 2d 515 (1983). Section 541(d) of the Code, however, circumscribes the scope of the estate such that

property in which the debtor holds . . . only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d).

"It is necessary to examine whether the debtor owns the property absolutely, conditionally, or merely through some lesser relationship, such as a bailment, agency, or consignment, whereby the goods [or funds] actually belong, save for the debtor's right to possession, completely to another." Central Ins. Co. v. First Cent. Fin. Corp. (In re First Cent. Fin. Corp.), 269 B.R. 481, 487-88 (Bank. E.D.N.Y. 2001) (quoting 5 Collier on Bankruptcy (MB) P541.06[1][a] (15th rev. ed. 2001)). The

nature and extent of the debtor's interest in property is determined by applicable non-bankruptcy law. Butner v. United States, 440 U.S. 48, 54-55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979).

Thus, the characterization of the property interests giving rise to ownership rights in the disputed funds is central to the resolution of whether federal grant funds are part of the Debtor's bankruptcy estate under § 541(d). In its analysis of a closely analogous federal grant scheme, the Seventh Circuit aptly characterized the present problem. In In re Joliet-Will County Community Action Agency, 847 F.2d 430, 432 (7th Cir. 1988), the court stated that whether federal grants are property of the bankruptcy estate

depends on the terms under which the grants were made. Did [the terms] constitute [the debtor] a trustee, custodian or other intermediary, who lacks beneficial title and is merely an agent for the disbursal of funds belonging to another? If so, the funds were not assets of the estate . . .. Or were the grants more like payment under a contract for promised performance not actually performed? The promisee would have a contractual claim for the return of the money he had paid, but he would not have a property right in the money.

Accordingly, the Court must first catagorize the nature of the property interests in play. Here, to the extent that both legal and equitable title in the Reimbursements rest in the Debtor under non-bankruptcy law, the City will be limited to a claim against the estate subject to the same pro-rata treatment provided to similarly situated unsecured creditors. See Cent. Ins. Co., 269 B.R. at 487-88. On the other hand, if the Debtor holds only bare legal title as a conduit channeling federal grants to the City,

the funds are out of the reach of the Debtor's creditors pursuant to § 541(d).

A. The Nature of Property Interests Arising Under the Universal Service Program

The Creditors posit that the City "entered into a contract with the Debtor, which provided a contractual expectation of payment . . . i.e., that [it] would [be] paid for goods and services provided to the Debtor." Under this logic, the Debtor entered into a contract with the City to remit the Reimbursements once issued by USAC. Therefore, they maintain that the City is a general unsecured creditor holding a contract "claim" against the Debtor within the meaning of 11 U.S.C. § 101(5)(A). n6 See In re CRS Steam, 225 B.R. 833, 840 (Bank. D. Mass. 1998). The Creditors further characterize the Reimbursements as an "account receivable" of the Debtor.

This Court strongly disagrees with the foregoing characterization of the transactions here involved and rules that the City's rights to the funds fall outside the scope of the Code's definition of "claim" altogether. The Creditors misconstrue the nature of the transactions as well as the parties to the transactions. This confusion is easily resolved, however, once we understand that there are two separate and distinct transactions. Though both stem from a single federal statutory scheme, each transaction vests different property interests arising under state and federal law, respectively.

Under the BEAR payment method, the first transaction arises out the mandate of 47 C.F.R. § 54.504(c) n7, which requires that applicants must enter into private contracts with service providers to qualify for E-rate discounts. It is important to note that neither the FCC

nor USAC become a party to such contracts. On the contrary, the FCC regulation is clear that the applicant must enter into a service contract with a qualified service provider. Id. The service provider's contractual relationship with the applicant is, and should be, governed by state law.

The second transactional relationship arising under the BEAR method of payment is the grantor/grantee relationship between USAC and the applicant; namely, the applicant becomes entitled to receive reimbursement from the Universal Service Fund. See Joliet-Will, 847 F.2d at 432-33 (finding that federal funds distributed to a non-profit organization created a grantor/grantee relationship whereby the funds remained property of the federal government and thus outside the reach of the recipient's creditors in a bankruptcy case); Westmoreland Human Opportunities, Inc. v. Walsh (In re Life Serv. Sys, Inc.), 246 F.3d 233, 236-40 (3rd Cir. 2001) (applying the same reasoning to federal funds distributed under the Department of Housing and Urban Development's Supportive Housing program); Connecticut Dept. of Trans. v. Novak (In re Comm. Assoc., Inc.), 173 B.R. 824, 828 (D. Conn. 1994) (applying the same holding in the context of federal grants distributed to state governments under the Urban Mass Transit Act). This grantor/grantee relationship is exclusively a child of a federal statutory scheme and federal regulation, and is, and should be, governed by federal law.

Under the particular payment mechanism agreed to under the Central High School and Network Maintenance contracts, the obligations of both parties to these contracts were fully satisfied. The Debtor performed the services required under the contracts and the City paid the full value of the services performed.

There is no further obligation of the Debtor to the City which could be characterized as a right to payment or an equitable remedy for breach of a performance giving rise to such a right. n8 Accordingly, the City has no "claim" against the Debtor as defined by § 101(5). To the extent that the City had an "expectation of payment" and thus a "claim" at all, it would be a claim against USAC arising out of the City's separate relationship with USAC as a grantee of federal funds under the Universal Service program.

Finally, the Debtor has no claim against USAC, both because USAC was not a party to the Debtor's contract with the City and because the Debtor was, in any event, paid in full for the Central High School and Network Maintenance Projects. n9 The Debtor is owed nothing by USAC. It is the City that is owed money from the Universal Service Fund. Accordingly, the Creditors' characterization of the USAC Reimbursements as accounts receivable due to the Debtor is erroneous.

The only relevant question in the present dispute, therefore, is whether the Debtor has any ownership interest in the Reimbursements arising from the second transaction, namely the grantor/grantee relationship between USAC and the City. For the funds to be deemed property of the estate under § 541(d), the Debtor must hold both legal and equitable title in the Reimbursements.

B. Legal and Equitable Title to the Reimbursements Under § 541(d)

At the outset, this Court concludes that the Debtor has legal title to the Reimbursements. Because all reimbursements owed by USAC are made by check payable to the service provider, the Debtor has at least

bare legal title thereto. See USAC/SLD Serv. Prov. Manual at 2-3. The more difficult question is whether equitable title to the Reimbursements vests in the Debtor as well. To answer this question, the Court looks to whether the Debtor holds the Reimbursements in trust on behalf of the City. "Because [a] debtor does not own an equitable interest in property [it] holds in trust for another, that interest is not 'property of the estate.'" Begier v. IRS, 496 U.S. 53, 58, 110 S. Ct. 2258, 2263, 110 L. Ed. 2d 46 (1990).

Neither the Act nor FCC regulations create an express trust relationship between the holders and beneficiaries of reimbursements from the Universal Service Fund. See Ross v. U.S., 148 F. Supp. 330, 332 (D. Mass. 1957) (stating that an express trust requires an "affirmative intention manifested by the settlor to create a trust"). Cf. 26 U.S.C. § 7501(a) (2002) (providing that revenue taxes collected by intermediaries constitute a special fund in trust for the United States). Indeed, the Act specifically states that the "telecommunications carrier shall . . . receive reimbursement." 47 U.S.C. § 254(d)(ii) (emphasis supplied); 47 C.F.R. § 54.501(a) ("telecommunications carriers shall be eligible for universal service support . . .."). However, notwithstanding the absence of express trust language, the Court must determine whether the reimbursements issued under BEAR transactions should be deemed to be held in a resulting or constructive trust on behalf of the grantee school or library. This Court finds in the affirmative.

1. Resulting Trust

"A resulting trust arises where a transfer of property is made under circumstances which raise an inference that the person making the transfer or causing it to be made

did not intend the transferee to have the beneficial interest in the property transferred." Restatement (First) of Restitution § 160 cmt. b (1936); Restatement (Third) of Trusts § 7, cmt. a. (Tentative Draft No. 1, 1996); Ross, 148 F. Supp. at 332. See also, In re Monarch Capital Corp., 130 B.R. 368, 376 (Bank. D. Mass. 1991).

The terms of the BEAR transaction satisfy the requirements of a resulting trust. Although the language of the Act and its underlying regulations create convoluted, cumbersome reimbursement mechanisms, it is clear from the FCC forms and USAC procedures that the service provider is not intended to hold beneficial title to the funds under the BEAR payment method. From the very outset of the BEAR transaction, the service provider is made aware of its duty to remit the reimbursement proceeds to the applicant within 10 days of receipt. See BEAR Form, Block 4.

Furthermore, the language in the USAC Service Provider Manual creates a strong inference that USAC intended that the beneficial interest in the reimbursed funds would not inure to the service provider. The USAC Service Provider Manual clearly states that the service provider "functions merely as a vehicle to deliver the reimbursement back to the applicant." USAC/SLD Serv. Prov. Manual Ch. 9 at 1. Moreover, by providing that the service provider's failure to promptly remit the funds to the beneficiary will result in enforcement action, USAC has unequivocally expressed its intention that equitable title to the reimbursement shall vest in the applicant, not the service provider. Id. Accordingly, the Debtor here does not have equitable title in the Reimbursements because it holds the funds in a resulting trust for the City.

2. Constructive Trust

Alternatively, the Court holds that the Debtor lacks equitable title in the Reimbursements because it holds the funds under constructive trust for the benefit of the City.

a. Applicable Law

Both the City and the Creditors view the application of a constructive trust to be controlled by state law. Under Massachusetts law, a court may apply a constructive trust approach only where the plaintiff has established that the property in dispute was acquired by fraud, mistake, breach of duty, or in other circumstances indicating the holder would be unjustly enriched. Fortin v. Roman Catholic Bishop, 416 Mass. 781, 625 N.E.2d 1352, 1357-58 (Mass. 1994). The Creditors claim that the City cannot meet this burden because no fiduciary relationship exists between the Debtor and the City and no affirmative wrongdoing by the Debtor can be established to support a finding of unjust enrichment.

The Court, however, believes that the more expansive federal common law standard of constructive trusts should apply in this case. See EBS Pension L.L.C. v. Edison Bros. Inc. (In re Edison Bros., Inc.), 243 B.R. 231, 236 (Bank. D. Del. 2000) (displacing state constructive trust law which required showing of fiduciary duty and fraud in determination of whether ERISA funds were property of the debtor under § 541(d)). As did the Third Circuit in Official Committee of Unsecured Creditors v. Columbia Gas Systems, Inc. (In re Columbia Gas Sys., Inc.), 997 F.2d 1039, 1059-60 (3rd Cir. 1993), cert denied 510 U.S. 1110, 114 S. Ct. 1050, 127 L. Ed. 2d 372, 114 S. Ct. 1051 (1994), this Court believes that the federal interests involved in the FCC's regulatory distribution of

federal funds merit application of federal common law. A matter relating to the federal treasury raises "a uniquely federal question." United States v. Swiss Am. Bank, 191 F.3d 30, 42-43 (1st Cir. 1999) citing to Clearfield Trust Co. v. United States, 318 U.S. 363, 63 S. Ct. 573, 87 L. Ed. 838 (1943) ("Since Clearfield, courts have often looked to federal common law to protect various proprietary interests of the United States."). "It is axiomatic that federal law governs questions involving the interpretation of a federal [regulation] . . ..". Columbia Gas, 997 F.2d at 1055.

In Columbia Gas, the Third Circuit followed the Supreme Court's directive in United States v. Kimbell Foods, 440 U.S. 715, 727-28, 99 S. Ct. 1448, 1458-59, 59 L. Ed. 2d 711 (1979)), in order to ascertain whether federal common law should displace state law. This "determination depends on the nature and importance of the government interest at issue and the effect of applying state law. Id.; Swiss Am. Bank, 191 F.3d at 44 (quoting Kimbell Foods). Three factors must be considered: (1) the need for a nationally uniform law; (2) whether incorporation of state law would frustrate specific objectives of the federal program at issue; and (3) the extent to which application of a federal common law rule would upset commercial expectations that state law would govern. Id.

All of the Kimbell Foods factors are satisfied in this case. There is a clear need for a uniform federal standard because the Universal Service Fund forms part of a federal statutory scheme designed to elevate and equalize the nation's telecommunications capability. Indeed, no state agency, but rather the FCC, a federal agency, exercises the sole regulatory oversight. Applying state law would frustrate Congress' objective of providing affordable telecommunications services

where such services would not be available without federal grants. n10 Further, those complying with the various procedures established by USAC and the FCC could have no reasonable expectation that the rights and responsibilities that flowed therefrom would be controlled by state law. Under these circumstances, the property interests in federal funds should not be left to "the vagaries of state trust law." Columbia Gas, 997 F.2d at 1055.

b. Constructive Trusts under Federal Common Law and § 541(d).

Where a statutory scheme devising disbursement of public funds is intertwined with regulations mandating private contractual agreements with third parties, the dichotomy between interests arising directly under the purview of the federal granting statute and those arising under the incidental private agreements can often be obfuscated. In this regard, the Court finds the analysis presented in Yonkers Board of Education v. Richmond Children's Center (In re Richmond Children's Center), 58 B.R. 980 (S.D.N.Y. 1986), instructive. Although that case revolved around a state statutory scheme, the facts are closely analogous to the present case.

In Richmond, the debtor was a special needs facility located in the City of Yonkers. Although some children in the debtor's care were not residents of Yonkers, they also attended public schools in that city. A state statute provided for reimbursement of tuition fees to cities where non-resident children attended schools. Id. at 980-82.

Under the statutory scheme, reimbursement checks were not issued directly to the intended beneficiaries, the respective cities providing public education to non-

resident children. Instead, the statute required that each care facility enter into "contracts" with the cities providing that the care facility would transmit the state reimbursement funds to the individual school districts within 10 days of receipt. Id. at 982. In Richmond, the reimbursement checks issued to the care facility were accompanied by transmittal notes indicating that the checks represented "a pass-through payment to the Yonkers P.S." Id. at 981.

The issue in Richmond, as here, was whether the pass-through payments were property of the debtor care facility's estate under § 541. The bankruptcy court held that they were. The District Court for the Southern District of New York disagreed. Finding that the care facility was merely an intermediary channeling the funds from one party to another, the court held that the care facility held the reimbursements under a constructive trust for the benefit of the City of Yonkers. Id. at 982. The Richmond court ruled that the debtor had no beneficial interest in the reimbursement funds and specifically noted that the debtor was being paid for its medical care services under a separate contract. Id. The court concluded that "no debt was owed to the city by Richmond; the services provided by Yonkers were solely for the benefit of the children residing in the intermediate care facility, and not for the facility itself." Id.

The Third Circuit Court of Appeals has applied the same analysis in the context of a federal regulatory scheme. In Columbia Gas, 997 F.2d 1039, the Federal Energy Regulatory Commission ("FERC"), acting pursuant to its authority to regulate gas rates under the Nation Gas Act, ordered upstream providers of gas to refund past overcharges to intermediary gas providers. These intermediary gas providers were then to pass these

overcharge refunds to the end users, the consumers, who ultimately were the source of the overcharged funds. Id. at 1051-52.

The debtor Columbia Gas, an intermediary gas carrier, sought leave from the bankruptcy court to pass the refunds received pre-petition from upstream carriers to its customers. The Third Circuit held that these refunds were not property of the bankruptcy estate under § 541(d) and thus could pass directly to the debtor's customers. Id. at 1061. Applying federal common law, the court held that the debtor held the overcharge refunds in constructive trust for the benefit of its customers. Id. at 1059-60.

Rejecting the argument that no trust could exist where Congress had not so specifically provided, the Third Circuit reasoned first that Congress intended to include both express and constructive trusts in the limiting language of § 541(d). Id. at 1060. It found the following language in the legislative history of the statute instructive:

Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in constructive trust for the person to whom the bill was owed.

Id. at 1059 (quoting H.R. Rep. No. 95-595, at 368 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6324) (emphasis supplied). See also, T & B Scottdale Contractors, Inc. v.

United States., 866 F.2d 1372, 1376 (11th Cir. 1989) cert denied, 493 U.S. 846, 107 L. Ed. 2d 98, 110 S. Ct. 139 (1989) (stating, in context of contract clause establishing a constructive trust, that "the legislative history of 11 U.S.C.A. § 541 makes it clear that funds in the debtor's possession held for a third-party do not become part of the estate in bankruptcy.").

The court then concluded that the statutory reimbursement mechanism of "paying one entity which then forwards the money to the ultimate intended beneficiary" rendered the debtor a "'receiving and transmitting agent,' or a conduit, for money upstream suppliers owe to overcharged consumers." Columbia Gas, 997 F.2d at 1060-61 (quoting In re Penn Cent. Transp. Co., 486 F.2d 519, 523-27 (3rd Cir. 1973) en banc, cert denied 415 U.S. 990, 94 S. Ct. 1588, 39 L. Ed. 2d 886 (1974)) (emphasis added); In re United Milk Prod. Co., 261 F. Supp. 766, 768 (N.D. Ill. 1966) (holding that under a federal regulation redistributing pooled funds to milk suppliers, the distributing bottler "had no independent right [to refunds] but is merely . . . a delivery agent, transferring money from bottling handlers, to the raw milk producers entitled [to these funds].)."

Although the court found no express trust language in the FERC's order or regulations, it concluded that "[the] insurance example [in § 541(d)'s legislative history] evidences that Congress intended that when a debtor is a mere conduit for funds to travel from one party to another, it lacks equitable interest in the monies." Id. at 1059. The court found it instructive that the reimbursements were not payments for services rendered by the debtor. Columbia Gas, 997 F.2d at 1060. Equitable interests in the funds did not arise out of a private contractual agreement, but rather were created unilaterally by the FERC. Id.; Edison Bros., 243 B.R. at

237 (holding that property interests in refunds from over-funded ERISA plan were not contractual in nature but arose under federal law). See also, United States v. McConnell (In re Flying Boat, Inc.), 258 B.R. 869, 874 (N.D. Tex. 2001) (holding that under statute mandating that travel agencies collect INS inspection fees from passengers, the debtor travel agency did not owe the money for services rendered by the INS but was required to remit it by federal regulation). n11

Adopting the analysis employed in Columbia Gas, this Court is satisfied that, notwithstanding the absence of an explicit statutory or regulatory provision establishing a trust for the Reimbursements, the Debtor must be deemed to hold the federal funds for the benefit of the City under a constructive trust. As established supra, in the context of the BEAR payment method, the Reimbursements do not constitute payment to the provider for services rendered; the service provider has already been fully paid under a separate contract. The Debtor is thus merely a conduit responsible for remitting the funds from USAC to the ultimate beneficiary, the City. n12 Accordingly, the Reimbursements are not property of the estate pursuant to § 541(d) of the Bankruptcy Code.

In so holding, the Court is mindful of the Bankruptcy Code's policy of equitable distribution of property among similarly situated creditors, and the awkward fit of constructive trusts within that scheme. See In re Cox, 247 B.R. 556, 571-72 (Bank. D. Mass. 2000) (discussing constructive trust conflict with policy of the bankruptcy code and citing to the academic debate as to the fit of constructive trusts in bankruptcy); Skilled Nursing Prof. Serv. v. Sacred Heart Hosp., 175 B.R. 543, 558-50 (Bank. E.D. Penn. 1994) (same). See also, CRS Steam, 225 B.R. 833 at 838-40 (discussing different

approaches taken by courts implementing constructive trust in bankruptcy); XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.), 16 F.3d 1443 (6th Cir. 1994) (holding that constructive trusts "have no place in bankruptcy.").

Deeming constructive trusts to be a "judicial fiction" designed to fashion an equitable remedy, courts are uneasy in applying constructive trusts within the context of the distributory scheme of the Bankruptcy Code. See id.However, the special nature of interests invoked where federal law specifically allocates federal funds to implement a particular public benefit merits special consideration.

For the same reason, the Court notes that the scope of this holding is narrow. This Court limits its application of federal common law to cases, as the one at bar, where extensive federal regulations and federal funds form the core of the issue in question. See Sacred Heart Hosp., 175 B.R. 543 at 559 (noting that courts apply a broader standard of constructive trusts where a governmental body and/or a federal statutory scheme is involved).

C. The Bank as Bona Fide Purchaser

For the same reasons that the Reimbursements are not property the estate, they are not collateral of the Bank. The Bank argues that its status as a secured creditor renders the Bank a bona fide purchaser, whose rights are superior to those of a resulting or constructive trustee. See CRS Steam, 225 B.R. 833 at 838. The Bank offered no evidence at trial as to the quantity or quality of its awareness of the existence of Reimbursements at any point in time. However, the Court need not delve into that question. The Bank's argument fails for another

reason, namely, it is not a "purchaser" of a security interest in the Reimbursements.

The Bank did lend money to the Debtor and accordingly "purchased" a security interest in the Debtor's receivables within the meaning of Mass. Gen. Laws ch. 106 § 1-201(32) (2002). n13 Nevertheless, as set forth above, the Reimbursements are not the Debtor's receivables. The Debtor's receivables were the $ 1,096,180.28 owed to the Debtor on the Central High School Project and the $ 134,000 owed to the Debtor on the Network Maintenance Project. Those amounts, clearly the Bank's collateral, were paid to the Debtor in full by the City. By virtue of the City's payment of the sums due to the Debtor, the proceeds of those receivables were incorporated in the Debtor's assets, some or all of which were and are also collateral of the Bank. However, it is illogical to presume that, by virtue of its loans to the Debtor, the Bank "purchased" a security interest in a payment which constituted a reimbursement by a third party to one of the Debtor's account debtors. Unquestionably, the Bank provided no value to the Debtor for any such "purchase."

D. Jurisdiction to Compel the USAC Payment

Finally, this Court must consider USAC's argument that it is not subject to this Court's jurisdiction, insofar as the City requests that the Court order USAC to make the Reimbursements on a specific time frame. This Court agrees that it has no such jurisdiction.

The limits of this Court's jurisdiction are set forth in 28 U.S.C. § 1334(b) (2002). This Court may hear disputes which "arise under," "arise in" or are "related to" the Bankruptcy Code. The First Circuit Court of Appeals has recently distinguished these terms as follows:

"Arising under" proceedings are (at least) those cases in which the cause of action is created by title 11 . . .. "Arising in" proceedings generally are those that are not based on any right expressly created by title 11, but nevertheless, would have no existence outside of bankruptcy. [Wood v. Wood (In re Wood), 825 F.2d 90, 97 (5th Cir. 1987)]. "Related to" proceedings [are] proceedings which "potentially have some effect on the bankruptcy estate, such as altering the debtor's rights, liabilities, options, or freedom of action, or otherwise have an impact upon the handling and administration of the bankruptcy estate." In re G.S.F. Corp., 938 F.2d 1467, 1475 (1st Cir. 1991) (quoting Smith v Commercial Banking Corp. (In re Smith), 866 F.2d 576, 580 (3d Cir. 1989)).

New England Power Marine, Inc. v. Town of Tyngsborough (In re Middlesex Power Equip. & Marine, Inc.), 292 F.3d 61, 68 (1st Cir. 2002) (additional internal citations omitted).

This Court can draw on none of the above cited sources of jurisdiction to resolve the instant dispute between the City and USAC. The Reimbursements are not part of title 11 of the United States Code, but rather part of a federal statutory scheme contained in title 47 of the United States Code, the FCC regulations and USAC procedures. Accordingly, any cause of action relating thereto does not "arise under" title 11. Further, the rights surrounding the Reimbursements exist independently under non-bankruptcy law. Therefore, any dispute relating thereto would not "arise in" title 11. Finally, and perhaps ironically, having adopted the City's persuasive argument that the City has no claim against the Debtor on account of the Reimbursements, the Court is compelled to the conclude that any dispute between the City and USAC with respect to those funds would have

no effect on the bankruptcy estate. Consequently, this Court has no "related to" jurisdiction over any such dispute.

IV. CONCLUSION

"Congress did not mean to authorize a bankruptcy estate to benefit from property that the debtor did not own." Vineyard v. McKenzie (In re Quality Holstein Leasing), 752 F.2d 1009, 1013 (5th Cir. 1985). The ownership rights in the Reimbursements are held by the City, not by the Debtor. Accordingly, the funds are available neither as collateral for the Bank, nor as a source of funds for a distribution to unsecured creditors.

For the reasons set forth above, the Court holds that the Reimbursements are not part of the Debtor's estate pursuant to § 541(d). This Court further rules that it has no jurisdiction to adjudicate any further dispute between the City and USAC.

A Judgment in conformance with this Memorandum of Opinion shall issue in conjunction herewith.

By the Court,
Henry J. Boroff
United States Bankruptcy Judge

Dated: August 16, 2002

JUDGMENT

For the reasons set forth in the Memorandum of Decision of even date, it is hereby

ORDERED, ADJUDGED and DETERMINED that:

1. pursuant to and in accordance with 11 U.S.C. § 541(d), the funds in the amount of $ 1,070,056.74 (the "Funds"), payable to the Defendant Lan Tamers, Inc. (the "Debtor"), by the Defendant, Universal Service Administrative Company ("USAC"), is not property of the Debtor's estate; and

2. no party in this adversary proceeding other than the Plaintiff, the City of Springfield, has any right or interest in the Funds; and

3. the Debtor shall promptly remit the Funds to the Plaintiff upon receipt of the Funds from USAC; and

4. the Court is without jurisdiction under 28 U.S.C. § 1334 to grant the Plaintiff the further relief requested against the Defendant, USAC.

By the Court,
Henry J. Boroff
United States Bankruptcy Judge

Dated: August 15, 2002

FOOTNOTES

n1 All of the parties except USAC filed a Stipulation as to facts which they considered uncontested (hereinafter, the "Stipulation").

n2 47 U.S.C.A. § 254(h)(B) provides in relevant part:

All telecommunications carriers . . . shall provide . . . services to elementary, secondary schools, and libraries for education purposes at rates less than the amounts charged for similar services to other parties. A

telecommunications carrier providing service under this paragraph shall—

(i) have an amount equal to the amount of the discount treated as an offset to its obligation to contribute to the mechanisms to preserve and advance universal service, or

(ii) . . . receive reimbursement utilizing the support mechanisms to preserve and advance universal service.

n3 Serv. Prov. Manual, Ch. 9 provides in relevant part:

The check is made out in the name of the service provider and may include payment amounts due to many applicants. That is, if your payment file included [applications] from 6 different applicants that all submitted BEARs, you would receive one check for the grand total of all 6 payments due . . . the Service Provider is responsible for passing the reimbursement amount through to the applicant(s).

n4 USAC's 10 month delay in responding to the FCC decision and its delay of another three (3) months in issuing the funding commitment letter was not explained.

n5 Without comment or opposition by any party, Counsel for the Official Unsecured Creditors Committee participated in the trial. The Court deems the Committee to have intervened, pursuant to Fed. R. Bankr. P. 7024(a)(2).

n6 11 U.S.C. § 101(5) (2002) defines a "claim" as

(A) right to payment [from the debtor], whether or not such right is reduced to judgment, liquidated,

unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy [against the debtor] for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

n7 47 C.F.R. § 54.504(c) provides:

Filing of FCC Form 471. An eligible school, library, or consortium that includes an eligible school or library seeking to receive discounts for eligible services under this subpart, shall, upon signing a contract for eligible services, submit a completed FCC Form 471 to the Administrator. A commitment of support is contingent upon the filing of FCC Form 471.

n8 All that remains of the Debtor's obligations to the City are those duties imposed by the FCC's regulations controlling disbursement mechanisms for the federal funds. But cf. Superintendent of Ins. v. First Cent. Fin. Corp. (In re First Cent. Fin. Corp.), 269 B.R. 481, 490 (Bank. E.D.N.Y. 2001) (holding that the debtor's subsidiaries had a right to payment of tax refunds issued to the debtor by the IRS because the refund was subject to a binding allocation agreement between the parent company and its subsidiaries).

n9 Of course, the situation would be different if the City and the Debtor had adopted the SPI method of payment, where the service provider receives a discounted payment from the applicant and the balance from USAC. However, under those circumstances, the Debtor would

be receiving the USAC monies on its own account and would have no claim against or remittance duties to the City.

n10 Indeed, the purpose of the Act would be particularly frustrated where, as here, the Debtor would essentially be paid twice for services rendered once and no funds would be available to fund the schools.

n11 By contrast, the court found that payments the debtor sought to provide the upstream providers for gas purchased pre-petition arose out of a separate contractual obligation for payment of services rendered, and were thus unsecured debts. Cf. Maine Cent. R.R. v. Boston & Maine Corp. (In re Boston and Maine Corp., Inc.), 600 F.2d 307, 308 (1st Cir. 1979) (noting that although the interline accounts in Penn Central may have been funds held in a constructive trust, use of train cars constituted a rental and thus a debtor/creditor relationship existed).

n12 In some instances, courts have found that equitable title to the funds never even vests in the grantee entity until it is used for the specific purpose to which they were intended. Thus, where the granting statute implements extensive regulatory oversight in the disbursement and use of public funds, courts have held that even the grantee entity is merely an agent of the government obligated to use public funds only for their designated use. Thus, when the grantee entity is in a bankruptcy proceeding, the public funds are not part of its bankruptcy estate unless the terms of the grant have been fulfilled. See Joliet-Will, 847 B.R. at 434-44 (grantee of federal funds is an intermediary performing a discrete task rather than a borrower free to exercise discretion in use of funds); Westmoreland Human

Opportunities, 246 F.3d at 246 (following Joliet-Will); In re Comm. Assoc., Inc., 173 B.R. 824 at 829 (same).

n13 Mass. Gen. Laws ch. 106, § § 1-201 (32)(33) provide:

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, security interest, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person or his nominee who takes by purchase.

C.A. No. 02-30143-MAP

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS

In Re:

LAN TAMERS, INC.

MEMORANDUM AND ORDER RE: BANKRUPTCY APPEAL

September 26, 2002

PONSOR, D. J.

This bankruptcy appeal arrives in an unusual context. A prompt decision is apparently necessary to avoid the lose by the City of Springfield of substantial federal reimbursement and additional funding.

Having reviewed the memoranda, the court has concluded that the appeal is without merit. Moreover, the scrupulous and detailed memorandum of Bankruptcy Judge Henry J. Boroff renders unnecessary any extended discussion here. For the reasons set forth in Judge Boroff's memorandum of August 16, 2002, this court holds that the funds in question, totaling $1,070,056.74, are not part of the debtor's estate. This is the only issue on appeal. The decision by Judge Boroff of August 16, 2002 in the adversary proceeding, City of Springfield v. Lan Tamers, Inc., is hereby AFFIRMED.

It is So Ordered.

MICHAEL A. PONSOR
U. S. District Judge

No. 02-2309

United States Court of Appeals For the First Circuit

IN RE: LAN TAMERS, INC.
Debtor

DAVID W. OSTRANDER, Trustee in Bankruptcy of LAN TAMERS, INC.
Appellant

v.

CITY OF SPRINGFIELD, MASSACHUSETTS
Appellee

UNIVERSAL SERVICE ADMNISTRATIVE COMPANY
Amicus Curiae

LAN TAMERS, INC.; THE BANK OF WESTERN MASSACHUSETTS; EDUCATION TECHNOLOGY, INC.
Defendants

Before
Boudin, Chief Judge,
Torruella and Selya, Circuit Judges,
Lynch, Lipez and Howard,
Circuit Judges.

Order of the Court Entered: June 18, 2003

The petition for rehearing having been denied by the panel of judges wbo decided the case and the petition for rehearing en banc having been submitted to the active judges of this court and a majority of the judges not having voted that the case be heard en banc, it is

ordered that the petition for hearing and petition for rehearing en banc be denied.

By the Court:
Richard Cushing Donovan, Clerk

[CC: Messrs. O'Connell, Collins, Carroll, Plumb, Bluver, Baldiga, Berman, and Strayer]

11 U.S.C. § 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings

from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case;

(3) any eligibility of the debtor to participate in programs authorized under the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; 42 U.S.C. 2751 et seq.), or any accreditation status or State licensure of the debtor as an educational institution;

(4) any interest of the debtor in liquid or gaseous hydrocarbons to the extent that—

(A)(i) the debtor has transferred or has agreed to transfer such interest pursuant to a farmout agreement or any written agreement directly related to a farmout agreement; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 365 or 544(a)(3) of this title; or

(B)(i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and

(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 542 of this title; or

(5) any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order that is made—

(A) on or after the date that is 14 days prior to the date on which the petition is filed; and

(B) under an agreement with a money order issuer that prohibits the commingling of such proceeds with property of the debtor (notwithstanding that, contrary to the agreement, the proceeds may have been commingled with property of the debtor),

unless the money order issuer had not taken action, prior to the filing of the petition, to require compliance with the prohibition.

Paragraph (4) shall not be construed to exclude from the estate any consideration the debtor retains, receives, or is entitled to receive for transferring an interest in liquid or gaseous hydrocarbons pursuant to a farmout agreement.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under

applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

47 U.S.C. § 254. Universal service

(a) Procedures to review universal service requirements

(1) Federal-State Joint Board on universal service

Within one month after February 8, 1996, the Commission shall institute and refer to a Federal-State Joint Board under section 410(c) of this title a proceeding to recommend changes to any of its regulations in order to implement sections 214(e) of this title and this section, including the definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for completion of such recommendations. In addition to the members of the Joint Board required under section 410(c) of this title, one member of such Joint Board shall be a State-appointed utility consumer advocate nominated by a national organization of State utility consumer advocates. The Joint Board shall, after notice and opportunity for public comment, make its recommendations to the Commission 9 months after

February 8, 1996.

(2) Commission action

The Commission shall initiate a single proceeding to implement the recommendations from the Joint Board required by paragraph (1) and shall complete such proceeding within 15 months after February 8, 1996. The rules established by such proceeding shall include a definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for implementation. Thereafter, the Commission shall complete any proceeding to implement subsequent recommendations from any Joint Board on universal service within one year after receiving such recommendations.

(b) Universal service principles

The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:

(1) Quality and rates

Quality services should be available at just, reasonable, and affordable rates.

(2) Access to advanced services

Access to advanced telecommunications and information services should be provided in all regions of the Nation.

(3) Access in rural and high cost areas

Consumers in all regions of the Nation, including low-

income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

(4) Equitable and nondiscriminatory contributions

All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.

(5) Specific and predictable support mechanisms

There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.

(6) Access to advanced telecommunications services for schools, health care, and libraries

Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h) of this section.

(7) Additional principles

Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this chapter.

(c) Definition

(1) In general

Universal service is an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services. The Joint Board in recommending, and the Commission in establishing, the definition of the services that are supported by Federal universal service support mechanisms shall consider the extent to which such telecommunications services—

(A) are essential to education, public health, or public safety;

(B) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;

(C) are being deployed in public telecommunications networks by telecommunications carriers; and

(D) are consistent with the public interest, convenience, and necessity.

(2) Alterations and modifications

The Joint Board may, from time to time, recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms.

(3) Special services

In addition to the services included in the definition of universal service under paragraph (1), the Commission may designate additional services for such support mechanisms for schools, libraries, and health care providers for the purposes of subsection (h) of this section.

(d) Telecommunications carrier contribution

Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. The Commission may exempt a carrier or class of carriers from this requirement if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be de minimis. Any other provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires.

(e) Universal service support

After the date on which Commission regulations implementing this section take effect, only an eligible telecommunications carrier designated under section 214(e) of this title shall be eligible to receive specific Federal universal service support. A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Any such support should be explicit and sufficient to achieve the purposes of this section.

(f) State authority

A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute,

on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

(g) Interexchange and interstate services

Within 6 months after February 8, 1996, the Commission shall adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.

(h) Telecommunications services for certain providers

(1) In general

(A) Health care providers for rural areas

A telecommunications carrier shall, upon receiving a bona fide request, provide telecommunications services which are necessary for the provision of health care services in a State, including instruction relating to such services, to any public or nonprofit health care provider that serves persons who reside in rural areas in that State at rates that are reasonably comparable to rates

charged for similar services in urban areas in that State. A telecommunications carrier providing service under this paragraph shall be entitled to have an amount equal to the difference, if any, between the rates for services provided to health care providers for rural areas in a State and the rates for similar services provided to other customers in comparable rural areas in that State treated as a service obligation as a part of its obligation to participate in the mechanisms to preserve and advance universal service.

(B) Educational providers and libraries

All telecommunications carriers serving a geographic area shall, upon a bona fide request for any of its services that are within the definition of universal service under subsection (c)(3) of this section, provide such services to elementary schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties. The discount shall be an amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities. A telecommunications carrier providing service under this paragraph shall—

(i) have an amount equal to the amount of the discount treated as an offset to its obligation to contribute to the mechanisms to preserve and advance universal service, or

(ii) notwithstanding the provisions of subsection (e) of this section, receive reimbursement utilizing the support mechanisms to preserve and advance universal service.

(2) Advanced services

The Commission shall establish competitively neutral

rules—

(A) to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms, health care providers, and libraries; and

(B) to define the circumstances under which a telecommunications carrier may be required to connect its network to such public institutional telecommunications users.

(3) Terms and conditions

Telecommunications services and network capacity provided to a public institutional telecommunications user under this subsection may not be sold, resold, or otherwise transferred by such user in consideration for money or any other thing of value.

(4) Eligibility of users

No entity listed in this subsection shall be entitled to preferential rates or treatment as required by this subsection, if such entity operates as a for- profit business, is a school described in paragraph (7)(A) with an endowment of more than $50,000,000, or is a library or library consortium not eligible for assistance from a State library administrative agency under the Library Services and Technology Act [20 U.S.C.A. §§ 9121 et seq.].

(5) Requirements for certain schools with computers having internet access

(A) Internet safety

(i) In general

Except as provided in clause (ii), an elementary or secondary school having computers with Internet access may not receive services at discount rates under paragraph (1)(B) unless the school, school board, local educational agency, or other authority with responsibility for administration of the school—

(I) submits to the Commission the certifications described in subparagraphs (B) and (C);

(II) submits to the Commission a certification that an Internet safety policy has been adopted and implemented for the school under subsection (l) of this section; and

(III) ensures the use of such computers in accordance with the certifications.

(ii) Applicability

The prohibition in clause (i) shall not apply with respect to a school that receives services at discount rates under paragraph (1)(B) only for purposes other than the provision of Internet access, Internet service, or internal connections.

(iii) Public notice; hearing

An elementary or secondary school described in clause (i), or the school board, local educational agency, or other authority with responsibility for administration of the school, shall provide reasonable public notice and hold at least one public hearing or meeting to address the proposed Internet safety policy. In the case of an elementary or secondary school other than an elementary or secondary school as defined in section 8801 of Title 20, the notice and hearing required by this clause may be limited to those members of the public with a relationship to the school.

(B) Certification with respect to minors

A certification under this subparagraph is a certification that the school, school board, local educational agency, or other authority with responsibility for administration of the school—

(i) is enforcing a policy of Internet safety for minors that includes monitoring the online activities of minors and the operation of a technology protection measure with respect to any of its computers with Internet access that protects against access through such computers to visual depictions that are–

(I) obscene;

(II) child pornography; or

(III) harmful to minors; and

(ii) is enforcing the operation of such technology protection measure during any use of such computers by minors.

(C) Certification with respect to adults

A certification under this paragraph is a certification that the school, school board, local educational agency, or other authority with responsibility for administration of the school—

(i) is enforcing a policy of Internet safety that includes the operation of a technology protection measure with respect to any of its computers with Internet access that protects against access through such computers to visual depictions that are–

(I) obscene; or

(II) child pornography; and

(ii) is enforcing the operation of such technology protection measure during any use of such computers.

(D) Disabling during adult use

An administrator, supervisor, or other person authorized by the certifying authority under subparagraph (A)(i) may disable the technology protection measure concerned, during use by an adult, to enable access for bona fide research or other lawful purpose.

(E) Timing of implementation

(i) In general

Subject to clause (ii) in the case of any school covered by this paragraph as of the effective date of this paragraph under section 1721(h) of the Children's Internet Protection Act, the certification under subparagraphs (B) and (C) shall be made—

(I) with respect to the first program funding year under this subsection following such effective date, not later than 120 days after the beginning of such program funding year; and

(II) with respect to any subsequent program funding year, as part of the application process for such program funding year.

(ii) Process

(I) Schools with internet safety policy and technology protection measures in place

A school covered by clause (i) that has in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C) shall certify its compliance with subparagraphs (B) and (C) during each annual program application cycle under this subsection, except that with respect to the first program funding year after the effective date of this paragraph under section 1721(h) of the Children's Internet

Protection Act, the certifications shall be made not later than 120 days after the beginning of such first program funding year.

(II) Schools without internet safety policy and technology protection measures in place

A school covered by clause (i) that does not have in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C)--

(aa) for the first program year after the effective date of this subsection in which it is applying for funds under this subsection, shall certify that it is undertaking such actions, including any necessary procurement procedures, to put in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C); and

(bb) for the second program year after the effective date of this subsection in which it is applying for funds under this subsection, shall certify that it is in compliance with subparagraphs (B) and (C).

Any school that is unable to certify compliance with such requirements in such second program year shall be ineligible for services at discount rates or funding in lieu of services at such rates under this subsection for such second year and all subsequent program years under this subsection, until such time as such school comes into compliance with this paragraph.

(III) Waivers

Any school subject to subclause (II) that cannot come into compliance with subparagraphs (B) and (C) in such

second year program may seek a waiver of subclause (II)(bb) if State or local procurement rules or regulations or competitive bidding requirements prevent the making of the certification otherwise required by such subclause. A school, school board, local educational agency, or other authority with responsibility for administration of the school shall notify the Commission of the applicability of such subclause to the school. Such notice shall certify that the school in question will be brought into compliance before the start of the third program year after the effective date of this subsection in which the school is applying for funds under this subsection.
(F) Noncompliance

(i) Failure to submit certification

Any school that knowingly fails to comply with the application guidelines regarding the annual submission of certification required by this paragraph shall not be eligible for services at discount rates or funding in lieu of services at such rates under this subsection.

(ii) Failure to comply with certification

Any school that knowingly fails to ensure the use of its computers in accordance with a certification under subparagraphs (B) and (C) shall reimburse any funds and discounts received under this subsection for the period covered by such certification.

(iii) Remedy of noncompliance

(I) Failure to submit

A school that has failed to submit a certification under

clause (i) may remedy the failure by submitting the certification to which the failure relates. Upon submittal of such certification, the school shall be eligible for services at discount rates under this subsection.

(II) Failure to comply

A school that has failed to comply with a certification as described in clause (ii) may remedy the failure by ensuring the use of its computers in accordance with such certification. Upon submittal to the Commission of a certification or other appropriate evidence of such remedy, the school shall be eligible for services at discount rates under this subsection.

(6) Requirements for certain libraries with computers having internet access

(A) Internet safety

(i) In general

Except as provided in clause (ii), a library having one or more computers with Internet access may not receive services at discount rates under paragraph (1)(B) unless the library—

(I) submits to the Commission the certifications described in subparagraphs (B) and (C); and

(II) submits to the Commission a certification that an Internet safety policy has been adopted and implemented for the library under subsection (l) of this section; and

(III) ensures the use of such computers in accordance with the certifications.

(ii) Applicability

The prohibition in clause (i) shall not apply with respect to a library that receives services at discount rates under paragraph (1)(B) only for purposes other than the provision of Internet access, Internet service, or internal connections.

(iii) Public notice; hearing

A library described in clause (i) shall provide reasonable public notice and hold at least one public hearing or meeting to address the proposed Internet safety policy.

(B) Certification with respect to minors

A certification under this subparagraph is a certification that the library—

(i) is enforcing a policy of Internet safety that includes the operation of a technology protection measure with respect to any of its computers with Internet access that protects against access through such computers to visual depictions that are–

(I) obscene;

(II) child pornography; or

(III) harmful to minors; and

(ii) is enforcing the operation of such technology protection measure during any use of such computers by minors.

(C) Certification with respect to adults

A certification under this paragraph is a certification that the library—

(i) is enforcing a policy of Internet safety that includes the operation of a technology protection measure with respect to any of its computers with Internet access that protects against access through such computers to visual depictions that are–

(I) obscene; or
(II) child pornography; and
(ii) is enforcing the operation of such technology protection measure during any use of such computers.

(D) Disabling during adult use

An administrator, supervisor, or other person authorized by the certifying authority under subparagraph (A)(i) may disable the technology protection measure concerned, during use by an adult, to enable access for bona fide research or other lawful purpose.

(E) Timing of implementation

(i) In general
Subject to clause (ii) in the case of any library covered by this paragraph as of the effective date of this paragraph under section 1721(h) of the Children's Internet Protection Act, the certification under subparagraphs (B) and (C) shall be made—
(I) with respect to the first program funding year under this subsection following such effective date, not later than 120 days after the beginning of such program funding year; and
(II) with respect to any subsequent program funding year, as part of the application process for such program funding year.

(ii) Process

(I) Libraries with Internet safety policy and technology protection measures in place
A library covered by clause (i) that has in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C) shall

certify its compliance with subparagraphs (B) and (C) during each annual program application cycle under this subsection, except that with respect to the first program funding year after the effective date of this paragraph under section 1721(h) of the Children's Internet Protection Act, the certifications shall be made not later than 120 days after the beginning of such first program funding year.

(II) Libraries without internet safety policy and technology protection measures in place

A library covered by clause (i) that does not have in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C)–

(aa) for the first program year after the effective date of this subsection in which it is applying for funds under this subsection, shall certify that it is undertaking such actions, including any necessary procurement procedures, to put in place an Internet safety policy and technology protection measures meeting the requirements necessary for certification under subparagraphs (B) and (C); and

(bb) for the second program year after the effective date of this subsection in which it is applying for funds under this subsection, shall certify that it is in compliance with subparagraphs (B) and (C).

Any library that is unable to certify compliance with such requirements in such second program year shall be ineligible for services at discount rates or funding in lieu of services at such rates under this subsection for such second year and all subsequent program years under this subsection, until such time as such library comes into compliance with this paragraph.

(III) Waivers

Any library subject to subclause (II) that cannot come into compliance with subparagraphs (B) and (C) in such second year may seek a waiver of subclause (II)(bb) if State or local procurement rules or regulations or competitive bidding requirements prevent the making of the certification otherwise required by such subclause. A library, library board, or other authority with responsibility for administration of the library shall notify the Commission of the applicability of such subclause to the library. Such notice shall certify that the library in question will be brought into compliance before the start of the third program year after the effective date of this subsection in which the library is applying for funds under this subsection.

(F) Noncompliance

(i) Failure to submit certification

Any library that knowingly fails to comply with the application guidelines regarding the annual submission of certification required by this paragraph shall not be eligible for services at discount rates or funding in lieu of services at such rates under this subsection.

(ii) Failure to comply with certification

Any library that knowingly fails to ensure the use of its computers in accordance with a certification under subparagraphs (B) and (C) shall reimburse all funds and discounts received under this subsection for the period covered by such certification.

(iii) Remedy of noncompliance

(I) Failure to submit

A library that has failed to submit a certification under clause (i) may remedy the failure by submitting the certification to which the failure relates. Upon submittal of such certification, the library shall be eligible for services at discount rates under this subsection.

(II) Failure to comply

A library that has failed to comply with a certification as described in clause (ii) may remedy the failure by ensuring the use of its computers in accordance with such certification. Upon submittal to the Commission of a certification or other appropriate evidence of such remedy, the library shall be eligible for services at discount rates under this subsection.

(7) Definitions

For purposes of this subsection:

(A) Elementary and secondary schools

The term "elementary and secondary schools" means elementary schools and secondary schools, as defined in section 7801 of Title 20.

(B) Health care provider

The term "health care provider" means—
(i) post-secondary educational institutions offering health care instruction, teaching hospitals, and medical schools;
(ii) community health centers or health centers providing health care to migrants;
(iii) local health departments or agencies;

(iv) community mental health centers;
(v) not-for-profit hospitals;
(vi) rural health clinics; and
(vii) consortia of health care providers consisting of one or more entities described in clauses (i) through (vi).

(C) Public institutional telecommunications user

The term "public institutional telecommunications user" means an elementary or secondary school, a library, or a health care provider as those terms are defined in this paragraph.

(D) Minor

The term "minor" means any individual who has not attained the age of 17 years.

(E) Obscene

The term "obscene" has the meaning given such term in section 1460 of Title 18.

(F) Child pornography

The term "child pornography" has the meaning given such term in section 2256 of Title 18.

(G) Harmful to minors

The term "harmful to minors" means any picture, image, graphic image file, or other visual depiction that—
(i) taken as a whole and with respect to minors, appeals to a prurient interest in nudity, sex, or excretion;
(ii) depicts, describes, or represents, in a patently offensive way with respect to what is suitable for

minors, an actual or simulated sexual act or sexual contact, actual or simulated normal or perverted sexual acts, or a lewd exhibition of the genitals; and **(iii)** taken as a whole, lacks serious literary, artistic, political, or scientific value as to minors.

(H) Sexual act; sexual contact

The terms "sexual act" and "sexual contact" have the meanings given such terms in section 2246 of Title 18.

(I) Technology protection measure

The term "technology protection measure" means a specific technology that blocks or filters Internet access to the material covered by a certification under paragraph (5) or (6) to which such certification relates.

(i) Consumer protection

The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable.

(j) Lifeline assistance

Nothing in this section shall affect the collection, distribution, or administration of the Lifeline Assistance Program provided for by the Commission under regulations set forth in section 69.117 of title 47, Code of Federal Regulations, and other related sections of such title.

(k) Subsidy of competitive services prohibited

A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to

interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

(l) Internet safety policy requirement for schools and libraries

(1) In general

In carrying out its responsibilities under subsection (h) of this section, each school or library to which subsection (h) of this section applies shall—
(A) adopt and implement an Internet safety policy that addresses–
(i) access by minors to inappropriate matter on the Internet and World Wide Web;
(ii) the safety and security of minors when using electronic mail, chat rooms, and other forms of direct electronic communications;
(iii) unauthorized access, including so-called "hacking", and other unlawful activities by minors online;
(iv) unauthorized disclosure, use, and dissemination of personal identification information regarding minors; and
(v) measures designed to restrict minors' access to materials harmful to minors; and
(B) provide reasonable public notice and hold at least one public hearing or meeting to address the proposed Internet safety policy.

(2) Local determination of content

A determination regarding what matter is inappropriate

for minors shall be made by the school board, local educational agency, library, or other authority responsible for making the determination. No agency or instrumentality of the United States Government may—

(A) establish criteria for making such determination;

(B) review the determination made by the certifying school, school board, local educational agency, library, or other authority; or

(C) consider the criteria employed by the certifying school, school board, local educational agency, library, or other authority in the administration of subsection (h)(1)(B) of this section.

(3) Availability for review

Each Internet safety policy adopted under this subsection shall be made available to the Commission, upon request of the Commission, by the school, school board, local educational agency, library, or other authority responsible for adopting such Internet safety policy for purposes of the review of such Internet safety policy by the Commission.

(4) Effective date

This subsection shall apply with respect to schools and libraries on or after the date that is 120 days after December 21, 2000.